STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	:	
	:	
	:	**Docket No. 14-0312**
Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act.	:	

INITIAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, pursuant to the direction of the Administrative Law Judges ("ALJs") and Section 200.800 of the Illinois Administrative Code (83 Ill. Adm. Code 200.800), respectfully submits its initial brief in the above-captioned matter.

I. INTRODUCTION / STATEMENT OF THE CASE

Section 16-108.5(d) of the Public Utilities Act ("Act") provides in relevant part:

> (d) Subsequent to the Commission's issuance of an order approving the utility's performance-based formula rate structure and protocols, and initial rates under subsection (c) of this Section, the utility shall file, on or before May 1 of each year, with the Chief Clerk of the Commission its updated cost inputs to the performance-based formula rate for the applicable rate year and the corresponding new charges. Each such filing shall conform to the following requirements and include the following information:

220 ILCS 5/16-108.5(d).

Subsection 16-108.5(d)(1) of the Act further provides that:

> <u>The inputs to the performance-based formula rate for the applicable rate year shall be based on final historical data reflected in the utility's most recently filed annual FERC Form 1 plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed.</u> The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior

> rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year. Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)(1) (emphasis added).

Subsection 16-108.5(d)(1) of the Act, also provides that:

> The filing shall also include a <u>reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year</u> (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year. Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)((1) (emphasis added).

Finally, subsection 16-108.5(d) of the Act provides that:

> Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately reconcile the <u>revenue requirement reflected in rates for each calendar year</u>, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, <u>with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been had the actual cost information for the applicable calendar year been available at the filing date.</u>

220 ILCS 5/16-108.5(d) (emphasis added).

On April 16, 2014, ComEd filed its annual update of cost inputs and reconciliation pursuant to Section 16-108.5 of the Act. (Chief Clerk Acknowledgement Letter, April 16, 2014.)

The FERC Form 1 used by ComEd to reconcile the revenue requirement in effect during 2013 (the prior rate year) with the actual revenue requirement is the FERC Form 1 for the year ended December 31, 2013. The historical FERC Form 1 along with projected plant additions and correspondingly updated depreciation reserve and expense used by ComEd to determine rates to be in effect during the 2015 rate year (applicable rate year) is also the FERC Form 1 for the year ended December 31, 2013. (ComEd Ex. 1.0, p. 7.)

Also on April 16, 2014, ComEd filed a Petition to Make a Housekeeping Revision and a Compliance Change to its Filed Performance Based Delivery Service Rate Formula ("Petition"). In its Petition, ComEd noted that "a housekeeping change should be made to the rate formula in order to make the formula more readily understood." Petition at 4. ComEd also noted that the Final Order in Docket No. 13-0318 required a change in the Cash Working Capital ("CWC") calculation inputs. *Id.*, p. 5. On May 8, 2014, Staff filed a Response stating Staff had no objection to ComEd's Petition, but making certain requests for the Commission's Order, that the Commission issue an Interim Order, and that the docket be re-opened to conduct a second phase to hear evidence related to (a) the issue of possible changes to schedules necessary to reflect future changes in the appropriate depreciation rate to apply to the projected plant additions and embedded plant in ComEd's formula rate revenue requirement, with the specific depreciation rate used for rates going into effect on January 1, 2015 to be determined in Docket No. 14-0312; (b) the issues raised in Docket No. 13-0501/13-0517 (Cons.); and (c) any other issues that may require a change to a formula rate schedule, appendix or workpaper. The ALJs granted Staff's request, and the Phase 2 of that docket is on-going.

On May 8, 2014, an initial status hearing was held in this matter. The parties agreed to a schedule setting forth dates for prefiled testimony, briefs and motions regarding prefiled testimony. (Tr., May 8, 2014, 5-6; Notice of Schedule, May 9, 2014.)

The following Staff witnesses submitted testimony in this case: Theresa Ebrey (Staff Exs. 1.0 and 7.0), Richard W. Bridal II (Staff Exs. 2.0, 6.0, and 8.0), Phil Hardas (Staff Ex. 3.0), Phil Rukosuev (Staff Exs. 4.0 and 9.0), and Greg Rockrohr (Staff Ex. 5.0).

In addition, to ComEd and Staff, the following parties have submitted testimony in this case: the People of the State of Illinois by Attorney General Lisa Madigan ("AG"); Enbridge Energy LP, University of Illinois, Thermal Chicago Corporation, Ford Motor Company, Sterling Steel Company, LLC, AbbVie, Inc., General Iron Industries, Inc., Caterpillar Inc., ExxonMobil Power & Gas Services, Inc., Chrysler Corporation, and Abbott Laboratories, Inc., individually and as members of the Illinois Industrial Energy Consumers ("IIEC"); the Illinois Manufacturer's Association, the Illinois Retail Merchants Association; the Illinois Chamber of Commerce; the Chicagoland Chamber of Commerce; the City of Chicago ("City"); Citizens Utility Board ("CUB"); Illinois Competitive Energy Association ("ICEA"); and Retail Energy Supply Association ("RESA").

Evidentiary hearings were held in this matter in Chicago, Illinois on September 27 and 28, 2014. Pursuant to the direction of the Administrative Law Judges, Staff's initial brief follows.

II. OVERALL REVENUE REQUIREMENT

A. 2015 Initial Rate Year Revenue Requirement

Staff's recommends 2015 Initial Rate Year Revenue Requirement presented in Appendix A, Schedule 1 FY, line 1 is $2,316,585,000.

B. 2013 Reconciliation Adjustment

Appendix A, Schedule 8 FY computes the variance between the actual revenue requirement for 2013 and the revenue requirement that was reflected in delivery service charges applied during 2013. Interest for the period January 2013 through December 2015 is added to the variance and the total reconciliation adjustment of $199,532,000 is incorporated into the revenue requirement, which provides the basis for the 2015 delivery service rates. Staff's method of calculating the reconciliation adjustment presented on this schedule is identical to that included in the appendix to the Commission Orders in Docket Nos. 12-0321 and 13-0318. Only the amounts for the actual revenue requirement from Schedule 1 RY (line 1a), revenue requirement in effect during Reconciliation Year (line 1b), and the overall rate of return (line 2) are changed to reflect the values in this proceeding.

C. ROE Collar and ROE Penalty Calculation

Appendix A, Schedule 9 FY computes the adjustment necessary when the Company's earned return on common equity falls outside of the parameters of the earnings collar established by the Energy Infrastructure Modernization Act ("EIMA"). The calculation utilizes the actual operating expenses, rate base, and capital structure for 2013, inclusive of ratemaking adjustments and Commission disallowances as proposed by Staff. The delivery service revenues reflect actual revenues reported by the Company on FERC Form 1. The resulting adjustment is incorporated into the revenue requirement which is the basis for the 2015 delivery service rates. Appendix A, Schedule 9 FY demonstrates that ComEd's Delivery Service ("DS") ROE during 2013 falls within the ROE collar; therefore, no ROE collar adjustment is necessary.

D. 2015 Rate Year Net Revenue Requirement

Appendix A, Schedule 1 FY, line 5 presents the overall 2015 Rate Year Net Revenue Requirement per Staff of $2,516,117,000.

III. SCOPE OF THIS PROCEEDING

A. Changes to the Structure or Protocols of the Performance-Based Formula Rate

A separate case, Docket No. 14-0316, is considering the issue of what constitutes a change to the structure or protocols of the performance-based formula rate that cannot be addressed within a Section 16-108.5 annual update and reconciliation proceeding. The Commission's conclusions in that proceeding should be dispositive of the issues raised in ComEd's rebuttal to various adjustments proposed by Staff and Intervenors. The discussion of each of those issues is addressed in this brief under the specific related adjustment.

B. The Definition of Rate Year and the Reconciliation Cycle

C. Original Cost Finding

Staff recommends that the Commission include the following language in the Findings and Orderings paragraphs of its Order in this proceeding:

> (#) The Commission, based on ComEd's proposed original cost of distribution plant in service as of December 31, 2013, before adjustments, of $16,299,131,000, and reflecting the Commission's determination adjusting that figure, approves $16,275,590,000 as

> the composite original cost of jurisdictional distribution services plant in service as of December 31, 2013.

Staff recommends Original Cost amount should exclude costs that are recovered through Rider EDA, PORCB costs recovered outside of delivery service rates and supply administration costs recovered through Rider PE, since these costs are not part of delivery service plant in service. (Staff Ex. 1.0, p. 40, lines 845 – 850.)

The Company agrees with Staff's recommendation provided that the Commission makes a finding in its Order that an original cost finding will be made in future non-formula rate dockets where plant assets are considered. (ComEd Ex 13.0, p. 10.) Staff does not oppose that proposal.

D. Issues Pending on Appeal

IV. RATE BASE

A. Overview

1. 2013 Reconciliation Rate Base

Staff's proposed 2013 reconciliation Rate Base is $6,463,682,000 as presented on Appendix B, Schedule 3 RY.

2. 2015 Initial Rate Year Rate Base

Staff's proposed 2015 initial rate year Rate Base is $7,233,430,000 as presented on Appendix A, Schedule 3 FY.

B. Potentially Uncontested Issues

1. Plant in Service

a. Distribution Plant

b. General and Intangible Plant

c. Plant Additions

2. Materials & Supplies

3. Accumulated Deferred Income Taxes on Merger Cost Regulatory Asset

Staff proposed an adjustment to Accumulated Deferred Income Taxes ("ADIT") as a result of the Company's response to DR AG 6.13 concerning the classification of certain ADIT associated with the distribution formula rate reconciliation amounts. (Staff Ex. 1.0, p. 39.) The Company reflected the same adjustment in its rebuttal position revenue requirement (ComEd Ex. 13.0, p. 9.)

4. Construction Work in Progress

5. Regulatory Assets and Liabilities

Staff proposes an adjustment to correctly reflect the treatment of certain 2012 merger costs which impacted both Rate Base as well as the Operating Statement. The Company identified an additional error in its calculation of 2013 merger costs in responding to discovery. Both of these adjustments were included on Staff Ex. 1.0, Schedule 1.12. (Staff Ex. 1.0, pp. 37-38.) The Company accepts these adjustments. (Company Ex. 13.0, p. 14.)

6. Deferred Debits

7. Other Deferred Charges

8. Accumulated Provisions for Depreciation and Amortization

See Section V. C. 1. Depreciation for the Filing Year Revenue Requirement for a discussion of the Staff adjustment that impacts the Accumulated Provision for Depreciation and Amortization.

9. Accumulated Miscellaneous Operating Provisions

10. Asset Retirement Obligation

11. Customer Advances

Staff proposes an adjustment to revise Customer Advances for Construction since the Company indicated in response to discovery that its elimination of certain advances are overstated. (Staff Ex. 1.0, p. 38.) The Company accepts Staff's adjustment. (ComEd Ex. 13.0, p. 8.)

12. Customer Deposits

13. Cash Working Capital (issues not identified in IV. C.)

a. Overview of CWC and ComEd's lead/lag study

b. Payroll and withholding expense lead days and derivative changes to FICA tax and employee benefits – other Expense Leads

Staff proposes that the Cash Working Capital ("CWC") for Payroll and Withholding expense lead days should use the revised 16.19 lead days reflected in the Company response to Staff DR TEE 5.04 rather than the 14.86 lead days included in the Company's original filing. (Staff Ex. 1.0, p. 29.) The Company accepts these revisions. (ComEd Ex 14.0, p. 2.)

c. Final CWC calculation should reflect applicable adjustments to inputs

Both Staff and the Company agree that the CWC calculations should ultimately be calculated using the revenue requirement approved by the ICC in this proceeding. (Staff Ex. 1.0, p. 10; ComEd Ex. 14.0, p. 18.)

14. Other (including derivative adjustments)

C. Potentially Contested Issues

1. Cash Working Capital

a. Pension and OPEB expense leads

Staff proposes a payment lead of 203.24 days for pension and OPEB expense instead of the zero days utilized by the Company. Staff's proposal is based on actual payment information provided by the Company during discovery since the Company had not performed a study of the actual cash inflows and outflows associated with pension expense. While the Company does not agree with Staff's proposal to use 203.24 days, the Company does not take issue with the *calculation* of that amount for the lead days.

The Company claims that since the payments for pension and OPEB costs are included in the pension asset recorded on the Company's books as well as the OPEB liability included in rate base, then Staff's proposed treatment for CWC purposes would double-count those costs. Staff disagrees with that claim.

The Company's total operating revenues (source of cash) includes a component for both the pension asset cost funding amount as well as the pension and OPEB expense since both are included in the Company's operating statement. However, the Company reduces the total operating revenues on ComEd Ex 3.02 WP3 for only the pension asset cost funding when deriving the total revenues for the CWC calculation (Appendix A, Schedule 10, p.2, line 5) and does not make a reduction for the pension and OPEB *expense* included in revenues. Therefore, the source of cash in the CWC calculation includes pension and OPEB expense, yet according to the Company, the cash outlays or uses of cash for the CWC calculation should not reflect the pension and OPEB expense. Thus, the CWC calculated by the Company is overstated since it includes a component for the cash inflows (revenues) but not the cash outflows (expenses) associated with the pension and OPEB expense.

A review of the CWC schedules shows that both the cash inflows and cash outflows associated with the Pension Asset are removed from the CWC calculations. (Appendix A, Schedule 10, p.2, lines 5 and 22.) The only component for the OPEB liability included in revenues is the return on rate base which is also effectively accounted for in the CWC calculation through the reduction for return on equity (Appendix A, Schedule 10, p. 2, line 8) and the interest expense. (Id., p. 1, line 28.) There is no double-counting of pension and OPEB *expense* as the Company claims.

Staff's proposal in this case is consistent with a recent Commission decision concerning the expense lead for Pension and OPEB costs in a lead/lag study. In Docket No. 12-0511/12-0512 (Cons.), the Commission rejected the proposal of Peoples Gas and North Shore to set lead values for pension and OPEB expense at zero in the lead-lag study. In that case, Peoples Gas and North Shore argued that because the Commission approved the use of zero lead days for pension and OPEB costs in Docket No. 11-0721, it was appropriate to also use zero lead days for Peoples and North Shore Gas. The Order disagreed with the Companies, stating:

> The Commission finds Staff's proposal that the expense leads for inter-company billing should be for pension and OPEB expenses in the CWC calculation is more appropriate and is hereby adopted. The Utilities' proposal to set lead values for Pension and OPEB at zero in the lead-lag study is not appropriate based on the evidence in the record. Staff's recommendation is consistent with the Companies' own methodology in the last rate case and this was approved by this Commission. Consistent with Staff's recommendations, the Commission assigns an expense lead of negative 33.91 days for pension and OPEB expenses in North Shore's CWC calculation and negative 35.23 days for Peoples Gas.

> The Commission finds that this method is more appropriate than the recommendations of the AG and the AG's proposal is rejected.

(Order, June 18, 2013, Docket Nos. 12-0511/12-0512 (Cons.), p. 80.)

b. Pass-through taxes revenue lags for the IIET and CIMF

To reflect revenue lag for Illinois Excise Taxes and City of Chicago Infrastructure Maintenance Fees, Staff eliminated service lag since pass-through taxes do not represent payment for utility services. Staff deducted service lag from the Company's total operating revenue lag (ComEd Ex. 4.0, p. 8, lines 162-163) resulting in revenue lag days for these pass-through taxes of 34.33 days (49.54 days less 15.21 days).

In Docket No. 11-0721, the Company's most recent case that considered a lead/lag study, the Commission agreed "with Staff's use of 36.04 lag days for pass-through taxes Illinois Excise Taxes and City of Chicago Infrastructure Maintenance Fees rather than the 51.25 lag days used by the Company." (Order, May 29, 2012, Docket No. 11-0721, p. 46.) This decision reflected the removal of the 15.21 service lag days for these pass-through taxes from the total revenue lag calculation. The issue was not raised in the subsequent ComEd formula rate proceedings, Docket Nos. 12-0293 or 13-0318, because a new lead/lag study was not offered for consideration in those cases.

In Docket No. 10-0467, ComEd's last general rate case, revenue lag days were set by the Commission to 39.26 days for the pass-through taxes, Illinois Excise Taxes and City of Chicago Infrastructure Maintenance Fees. (Order, May 24, 2011, Docket No. 10-0467, Appendix A, p. 17, lines 4 – 5.) The revenue lag of 39.26 days was equal to the operating revenue lag of 54.47days less the service lag of 15.21 days. While the Company claims that the exclusion of the service lag was somehow connected to the exclusion of the service lead, that dependency is not evident in the record or in the Commission conclusions for CWC.

c. Pass-through taxes expense leads

Staff proposes the expense lead days for the pass-through taxes based on the payment due dates rather than actual payment dates used by the Company. The Company responds that certain taxes were being paid several days prior to the due dates to mitigate the risk of interest and penalties, which could be significant. However, a number of other payments that are made via electronic means[1] are not remitted "early" simply because "failure" might occur. Moreover, the Energy Assistance Charges/Renewable Energy Charges ("EAC/REC") pass-through taxes as well as "Other Taxes" shown on ComEd Ex. 4.02, pp. 36 – 39 are all calculated based on payment due dates rather than actual payment dates. The Company has offered no explanation for the disparate treatment of payment lead measurement for pass-through taxes paid via the same electronic process. (Staff Ex. 1.0, p. 23; Staff Ex. 7.0, p. 11.)

d. Intercompany billings expense lead

Staff proposes to increase the Company's payment lead for inter-company billings to 30 days which results in the CWC calculation reflecting the payment of inter-company billings being paid 30 days after the month of service, which is the equivalent payment terms for non-affiliated vendors. The Company's expense lead days for inter-company billings is based on payment by the 15th of the month following service (ComEd Ex. 4.0, p. 13, lines 271 – 274) which, when included in the CWC calculation, results in the subsidization on the non-regulated operations by the regulated ratepayers.

[1] Among remittances that are made via electronic means and thus have zero bank float are: Payroll withholdings, Employee Benefits, Intercompany billings, property leases, Federal and State Income Taxes, Federal and State Unemployment Taxes, Electric Distribution Tax, State Franchise Tax,

Because the timing of payments to affiliated interests is within the Company's discretion, CWC should not be based upon payment lead days for goods and services provided by the Company's affiliates being less than payment lead-days for goods and services provided by non-affiliated vendors. Ratepayers should not be subsidizing the utility's affiliates through an increased cost of CWC. The Commission has previously made findings consistent with this position in its Orders in Docket Nos. 10-0467 and 11-0721. The issue was not raised in the subsequent ComEd formula rate proceedings, Docket Nos. 12-0293 or 13-0318, because a new lead/lag study was not offered for consideration in those cases.

The subsidization of affiliates is prohibited by reference in Section 5 of the GSA that states "that the determination of the costs as used in this Agreement shall be consistent with, and in compliance with, the rules and regulations of the SEC, as they now exist or hereafter may be modified by the Commission."[2] The Federal Energy Regulatory Commission ("FERC"), successor to the SEC in the governance of the allocation of costs between utility affiliates, issued Order No. 707 on February 7, 2008 "to ensure that customers of franchised public utilities do not inappropriately cross-subsidize the activities of 'non-regulated' affiliates, and are not otherwise harmed as a result of affiliate transactions and activities." (F.E.R.C. Order 707, Cross-Subsidization Restrictions on Affiliate Transactions Docket No. RM07-15-000, 122 FERC ¶ 61,155, p. 2 (Feb. 21, 2008).)

The Company's calculation of expense lead days for payments to vendors that provide other operation and maintenance services ("Other O&M") are reflected on

[2] The Energy Policy Act of 2005 repealed the Public Utility Holding Company Act of 1935, and gave the Federal Energy Regulatory Commission ("FERC") a limited role in the allocation of costs of multi-state electric utility holding companies to individual operating subsidiaries.

ComEd Ex. 4.02, pages 24 - 30. The Other O&M expense lead is composed of weighted averages of service leads, payment leads and float for the various payments. The 15 day payment lead used by the Company for inter-company billings is only 28.6% of the 52.41 day simple average payment lead the Company used for Other O&M CWC calculation.

In the Orders in Docket Nos. 10-0467, and 11-0721, the Commission increased the payment lead for inter-company billings by 15 days. Staff's proposal in this case is consistent with the treatment of inter-company billing expense lead days in the Final Orders in Docket Nos. 10-0467 and 11-0721. The Order in Docket No. 11-0721 states:

> The Commission agrees with Staff and finds that CWC should be reduced through a higher number of expense lead days on intercompany obligations consistent with the Final Order in the Company's most recent rate case, Docket 10-0467. The Commission finds that allowing ComEd to charge ratepayers a higher CWC requirement in order to pay the Company's affiliates earlier than non-affiliated vendors are paid is a form of cross-subsidization. The Commission also recognizes that ComEd's process for paying intercompany obligations has not changed since Docket 10-0467. That being the case, the Commission reasons that the conclusion here should mirror that of the Company's most recent rate case and accepts Staff's adjustment.

(Order, Docket No. 11-0721, May 29, 2012, p. 48.)

The Order in Docket No. 10-0467 states:

> Finally, with respect to payments of intercompany obligations, ComEd has not shown the need to reject Staff's adjustments in this area. According to the Company's initial brief, ComEd's affiliate invoices it on a monthly basis, on time, and the invoices require payments on or around the 15th of the month following the provision of service. Staff's adjustment is based on this statement. There was no mention of an affiliate agreement to the contrary. Therefore, the Commission accepts Staff's proposed number of expense lead days of 45.35, based on the fact that such payments are within the Company's discretion.

(Order, Docket No. 10-0467, May 24, 2011, p. 48.)

There is no compelling evidence for the Commission to change its conclusion from two prior cases considering the appropriate expense lead days for intercompany obligations.

2. Other

V. OPERATING EXPENSES

A. Overview

B. Potentially Uncontested Issues

1. Distribution O&M Expenses (issues not identified in V. C.)

2. Customer-Related O&M Expenses (issues not identified in V. C.)

3. Administrative and General Expenses (issues not identified in V. C.)

4. Charitable Contributions

5. 2013 Merger Expense

See Section IV. B.5. Regulatory Assets and Liabilities for discussion of the issue which impacts both Rate Base and Operating Expenses.

6. Sales and Marketing Expenses

7. Depreciation and Amortization Expense (issues not identified in V. C.)

Staff does not take issue with the 2013 reconciliation year Depreciation and Amortization Expense, however, see Section V.C.1. for discussion of Staff's position regarding the Depreciation and Amortization Expense for the Filing Year Revenue Requirement.

8. Regulatory Asset Amortization

9. Operating Cost Management Efforts

10. Lobbying Expense

11. Rate Case Expenses

Staff proposed adjustments to rate case expense to remove certain expenses that are not reasonable to prepare and litigate a rate case filing. The adjustments set forth in Staff's Schedule 2.01 disallowed the following costs from rate case expense:

1) Company-identified rate case expense invoice line items for which ComEd states it is no longer requesting recovery and which ComEd states are not associated with rate case expense;

2) Rate case expense invoice line items which were completely redacted within the provided supporting documentation; and

3) Miscellaneous charges for attorney and witness meals.

(Staff Ex. 8.0, p. 4.) In order to limit the issues in this proceeding, ComEd is no longer seeking recovery of the Company-identified costs, costs associated with invoice line items which were completely redacted, and costs associated with attorney and witness meals. (ComEd Ex. 13.0, pp. 14-15.)

Section 9-229 Recommendation Regarding Rate Case Expense

Section 9-229 of the Act requires the Commission to specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing in the Commission's final order. 220 ILCS 5/9-229. If the Commission makes any adjustments to rate case expense, those adjustments should also be considered in the Commission's statement that sets forth the amount of rate case expense included in the revenue requirement. Therefore, Staff recommends that the Order in this proceeding express a Commission conclusion as follows:

> The Commission has considered the costs expended by the Company during 2013 to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assesses that the amount included as rate case expense in the revenue requirements of $3,097,176 is just and reasonable. This amount includes the following costs: (1) $826,820[3] amortized rate case expense associated with the initial formula rate proceeding, Docket No. 11-0721; (2) $2,280,395[4] associated with Docket No. 13-0318; and (3) $(10,039)[5] associated with the litigation of Dockets No. 07-0566, 10-0467, 12-0321, and 14-0312.

12. Corporate Credit Cards

Staff proposes an adjustment to remove from the revenue requirement costs associated with certain Company credit card charges by Company employees. Staff's adjustment removes: (1) amounts associated with employee recognition, (2) amounts for working lunches, and (3) other meals and food provided to employees. Charges for these items may arguably encourage Company employees or improve the Company employees' work experience, but purchases of these items have not been shown to be prudent, just and reasonable, nor necessary for the provision of regulated utility service. In addition, the costs have not been shown to enhance the customer experience or benefit ratepayers. As such, the costs should be removed from the revenue requirement. (Staff Ex. 8.0, pp. 8-12.)

In order to resolve this issue for purposes of this case, and to avoid the need for further testimony on contested credit card charges, ComEd accepted and no longer contests Staff's adjustment. (ComEd Ex. 24.0, pp. 1-2.) Further, ComEd committed to,

[3] *See* Staff Ex. 2.0, Schedule 2.01, p. 2, ln. 11. Rate case expense amount included in the revenue requirements and related to Docket No. 11-0721 consists of 1/3 of the one-time filing fee incurred during 2011 plus 1/3 of the Docket No. 11-0721 rate case expenses incurred during 2012 and 1/3 of the Docket No. 11-0721 rate case expense incurred during 2013, as permitted by Section 16-108.5(c)(4)(E) of the Act. 220 ILCS 5/16-108.5(c)(4)(E).

[4] *See* Staff Ex. 2.0, Sch. 2.01, p. 3, ln. 6. Rate case expense included in the revenue requirements and related to Docket No. 13-0318 is not amortized.

[5] *See* Staff Ex. 2.0, Sch. 2.01, p. 4, ln. 10 less $98 correction identified in ComEd Ex. 13.0, 15. Rate case expense included in the revenue requirements and related to these proceedings is not amortized. Amount is a credit due to a refund associated with Docket No.12-0321.

subsequent to the completion of this proceeding, meet and work constructively with Staff to attempt to narrow and resolve in future proceedings the concerns regarding credit card costs like those objected to by Staff in this proceeding. Id. at 2; (ComEd Cross Ex. 2.)

13. Gross Revenue Conversion Factor

C. Potentially Contested Issues

1. Depreciation for the Filing Year Revenue Requirement

Staff proposes to adjust Depreciation Expense, Accumulated Depreciation, and the associated ADIT for the filing year revenue requirement to reflect the revised depreciation rates that became effective in January 2014 and to apply the updated depreciation rates to the gross 2014 projected plant additions. (Staff Ex. 1.0, pp. 33-34.) The Company argues that only the depreciation associated with the weighted average of the actual 2013 plant additions and the 2014 projected plant additions should reflect the updated depreciation rates. Staff's methodology to calculate filing year depreciation expense due to updated depreciation rates is consistent with the treatment approved by the Commission in Docket Nos. 13-0501/13-0517 (Cons.), which was an extension of Docket No. 13-0301, the first formula rate proceeding which considered the treatment of a depreciation rate change. These dockets concerned Ameren Illinois Company ("AIC"). In the Interim Order in Docket No. 13-0501/0517 (Cons), the Commission found:

> The Commission notes that Staff proposes an adjustment to reflect the incremental amount of depreciation expense and related changes to rate base components due to the utilization of depreciation rates from AIC's updated depreciation rate study that became effective January 1, 2013. Staff states that it recommends reflecting the impact of the utilization of AIC's updated depreciation rates only in the FY Revenue Requirement, as

> the RY Revenue Requirement is based on 2012 actual information, and would, therefore, not be affected by the new 2013 depreciation rates. CUB also supports Staff's position on this issue.
>
> Likewise, the Commission notes that AIC agrees that Mr. Ostrander's adjustment is appropriate because it appropriately matches the 2013 projected plant additions with the best available estimate of the 2013 depreciation expense. The Commission notes that AIC believes use of the updated depreciation rates for 2013 has the additional benefit of limiting the reconciliation adjustment that will be required in the formula rate reconciliation proceeding concerning 2013. AIC notes that implementation of this adjustment will require a number of modifications to Schedule FR C-2 and its source information.
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> . . .
>
> The Commission believes that based on the evidence presented in the record in this docket that the proposal offered by Staff, supported by AIC and CUB, and partially supported by the AG, is appropriate and therefore it will be adopted in this proceeding. The Commission finds that it is unable to adopt the language offered by the AG, in light of the concerns expressed by AIC. The Commission does encourage AIC's efforts to bring clarity to the schedules and workpapers provided in these dockets, and will therefore encourage AIC to study the proposal offered by the AG as AIC's attempts to ensure that the documents provided assist in the understanding of each proceeding.

(Interim Order, November 26, 2013, Docket Nos. 13-0501/0517 (Cons) at 31-32.)

Staff's recommendation in this case is consistent with the method approved by the Commission in Docket Nos. 13-0501/13-0517 (Cons.) in its Interim Order. Staff's rationale stated above is the same Staff rationale in this docket. In order to maintain consistency in the application of Section 16-108.5, the Commission should approve the same treatment for ComEd as it did for Ameren for the reasons set forth above. (Staff Ex. 1.0, pp. 35-36.)

The Company's argument against Staff's adjustments is that it would (1) change the established rate formula during a formula rate update proceeding contrary to Section 16-108.5(d); (2) it is unnecessary because there will be a "true-up" in the future, and 3) it is inconsistent with a prior Staff position in Docket No.11-0721. (ComEd Ex 12.0, pp. 12 -13.) Each of these arguments are unfounded and should be dismissed for the following reasons.

First, the schedules that ComEd claims it would have to change to accommodate Staff's adjustments are not all necessary. The adjustment for the change in depreciation rates that Staff proposes in this proceeding is similar to that proposed by Staff and accepted by the Commission in Ameren Docket No. 13-0301 and that was further considered in Docket Nos. 13-0501/0517 (Cons.). In that case, all of the necessary changes were reflected on four lines of Schedule FR C-2 so that the amounts from Schedule FR C-2 flowed through to already existing lines on Schedule FR A-1. Schedule FR C-2 or supporting workpapers can be revised in such a way that no changes would be necessary to Schedule FR A-1. Thus, such revisions would not constitute a violation of Section 16-108.5(d) of the Act because Schedule FR C-2 and its supporting workpapers are not part of the performance-based formula rate structure or protocol.

Nonetheless, the Commission has acknowledged the need to settle the question of what constitutes a performance-based formula rate structure or protocol and which supporting schedules, appendices or workpapers would require Commission approval under Section 9-201 before any changes to them can be made. Thus, the Commission has ordered a Phase 2 to ComEd Docket No. 14-0316 to address these questions. In addition, the Commission set forth as part of the scope of Phase 2 of that proceeding the following:

> If the determination in (B) above is that the Commission must approve changes to all formula rate schedules, appendices and

> workpapers through a Section 9-201 proceeding, determine the necessary changes to be made to any of those documents to appropriately reflect the change in ComEd's depreciation rates between the reconciliation year and the filing year.

Therefore, the Commission decision in that case (anticipated to be issued on or before November 30, 2014) will be dispositive to this issue. As such, there is no further need to discuss this issue here.

Second, the Company mistakenly believes the "true up" in a future reconciliation will result in neutral customer impacts. The "true-up" in a future reconciliation will not "neutralize" the customer impact because interest (calculated for a three-year period on the reconciliation balance) will be collected from ratepayers in addition to the variance between the "actual revenue requirement" and the "revenue requirement in effect during the reconciliation year. (Staff Schedule 7.08 FY.)

By updating the depreciation expense on both the December 31, 2013 embedded plant and the 2014 gross projected plant additions for an entire year's depreciation at the depreciation rates that became effective January 1, 2014, Staff's adjustment minimizes the future reconciliation balance (either positive or negative) that will impact customer rates. Ms. Brinkman's discussion about future reconciliations insinuates that, should the adjustment Staff is proposing now have a different impact on the reconciliation balance in future cases, the Company might then be in favor of making a change at that time. (ComEd Ex. 12.0 REV, p. 16, lines 319 – 327.) The Company should not be allowed to arbitrarily decide when to make such adjustments.

Third, the initial formula rate filing for ComEd (Docket No. 11-0721) did not address the issue of how to reflect updated rates from a depreciation study in a filing year revenue requirement. While the Company and Staff agreed to add the footnote on Appendix 8, that footnote does not indicate that rates from the most recent depreciation study will be applied to *only* the projected plant additions. Rather the footnote reads as follows:

> If ComEd's FERC Form 1 does not reflect the most recent depreciation study, ComEd will update the formula with the most recent rates submitted to the ICC.

(ComEd Ex. 13.01, p. 28, Appendix 8.)

Staff interpreted that footnote to mean *everything* in the formula will be updated to reflect the most recent depreciation study rates. That understanding is consistent with the adjustment Staff is proposing here.

The Company incorrectly argues that "the use of weighted additions in the calculation of projected depreciation expense was established as a result of a well vetted agreement between ComEd and Staff witnesses in Docket No. 11-0721." (ComEd Ex. 12.0 REV, p. 14, lines 280 – 282.) Docket No. 11-0721 did not include either a depreciation study that established new depreciation rates or a reconciliation of a revenue requirement used to establish rates with the "actual" revenue requirement for a reconciliation year. Because both of those components are present in the ongoing formula rate case, Staff's analysis and review take a critical view of how those components are impacted depending on the treatment in the formula rate revenue requirement. Therefore, Staff's analysis is not dependent on the method of establishing depreciation expense that was used in Docket No. 11-0721 and the Company's argument must be rejected.

If the Commission does not approve Staff's recommendation for depreciation in the filing year, then ADIT associated with projected plant additions as proposed by the Company should be corrected. Staff's calculation for ADIT on projected plant uses the gross 2014 plant additions as the basis for both tax and book depreciation purposes. The Company's calculation of ADIT[6] is based on the difference between the tax depreciation expense calculated on 2014 projected plant additions and the book depreciation on projected additions calculated on the weighted average of 2014 projected additions and 2013 actual plant additions. This calculation would be incorrect if Staff's depreciation recommendation is not adopted because the basis for calculating both book and tax depreciation would not be the same for ADIT purposes. The Company would need to recalculate the tax depreciation on the weighted average of 2014 projected additions and 2013 actual plant additions so that the ADIT would be calculated on a consistent basis.

2. Incentive Compensation Program Expenses

a. Annual Incentive Program ("AIP")

Overview

Staff recommends that the Commission adopt the AG adjustment to disallow 100% of ComEd Annual Incentive Program ("AIP") incentive compensation. The entire ComEd AIP which the Company seeks to recover through its formula rate filing, approximately $50 million, intermingles operational goals, which benefit ratepayers, with protections benefitting shareholders in a manner that is: (1) contradictory to established Commission practice, and (2) contrary to Section 16-108.5(c)(4)(A). Because the determining factor for incentive compensation expense under ComEd's current AIP is Exelon's earnings per share, and not solely ComEd's "achievement of operational metrics, including metrics related to budget controls, outage duration and frequency,

[6] ComEd Ex. 3.02, p. 125, WP 19 (Public).

safety, customer service, efficiency and productivity, and environmental compliance," 220 ILCS 5/16-108.5(c)(4)(A), ComEd's plan creates mixed incentives for employees thereby calling into question the equity of charging ratepayers (as opposed to shareholders) for the expenses associated with such plan. Notwithstanding ComEd's testimony that the incentive compensation under the AIP plan is "awarded" and "earned" based upon the achievement of ComEd operational goals, ultimately, the amount of the AIP payout (or even if any is paid at all) and therefore the incentive compensation expense is contingent upon Exelon's earnings per share, regardless of whether ComEd employees meet goals of the eight operational metrics (called Key Performance Indicators ("KPI")). As ComEd must admit, neither "awarded" nor "earned" are used in Section 16-108.5(c)(4)(A). (Tr. p. 148:21-150:6, Aug. 27, 2014.) In addition, any claim that such compensation is "awarded" or "earned" prior to application of the Shareholder Protection Feature ("SPF") is inaccurate as the testimony of ComEd's witness admits that the employees have no claim, at any time, to the incentive compensation that is "awarded" or "earned" if the SPF would prohibit its payment. Id.

AG witness Mr. Brosch argues that the ComEd AIP incentive compensation award is subject to, and controlled by, Exelon's actual earnings per share ("EPS") and is, thus, not recoverable in ComEd's performance-based formula rate. (AG Ex. 1.0, pp. 3, 19, 28.) Mr. Brosch relies upon the language of Section16-108.5(c)(4)(A) of the Act in making his adjustment. While it is not disputed that Exelon's EPS is utilized in the determination of the final ComEd AIP incentive compensation expense through the operation of the SPF, the issue in this proceeding is whether ComEd AIP incentive compensation expenses are recoverable under the Act. This determination involves a legal interpretation of the language of the Act and an analysis of the plan's consistency with the Commission's past practice with regard to incentive compensation expense recovery. (Staff Ex. 8.0, pp. 31-32.)

Staff's testimony on the issue of the ComEd AIP addressed (i) ComEd's AIP incentive compensation award, (ii) AG witness Brosch's proposed adjustment to that award, and (iii) ComEd witnesses Brinkman's and Prescott's rebuttal testimony on incentive compensation. As stated in testimony, Staff witness Bridal has no policy objection to incentive compensation plans *per se*. Mr. Bridal understands that generally such programs can provide useful incentives to employees and, depending on the structure of such programs, can provide value to ratepayers. ComEd's entire AIP intermingles operational goals, however, which benefit ratepayers, with EPS protections benefitting shareholders in a manner that is contradictory to established Commission practice and is at odds with Section 16-108.5(c)(4)(A). (Staff Ex. 8.0, pp. 15-16.) Further, as became clear in ComEd's surrebuttal testimony and during the cross examination of ComEd witnesses at hearing, the AIP incentive compensation payout – the expense that was ultimately recorded in the ComEd financial statements and included in the ComEd revenue requirement in this proceeding – is impacted, determined, or based on Exelon EPS achievement.[7]

In the event the Commission does not agree that all of the AIP payout should be disallowed, the Commission can review the ComEd AIP expense and determine what portion of the AIP expense should reasonably be borne by ratepayers consistent with the Commission's past practice. One reasonable alternative that the Commission could

[7] See ComEd Ex. 31.0, 1-3:19-56; Tr. 150-151, Aug 27, 2014.

consider is allowing ComEd to recover the same level of Company KPI performance of 102.9% (which represents essentially a 2.9% bonus plus 100% of the fair market value of employee salaries, as determined by the Company) that the Commission authorized in prior ComEd formula rate dockets and described *infra*. This would result in an adjustment of approximately $(6,104,000) to the operating statement and $(4,006,000) to rate base. (ComEd Ex. 25.01.) Similar to its impact on the 2012 ComEd AIP incentive compensation expenses ultimately allowed in ComEd's prior formula rate proceeding, Docket No. 13-0318, the alternative 102.9% limiter proposed in this proceeding effectively negates any impact of the controversial EPS-based SPF on 2013 ComEd AIP incentive compensation. (ComEd Ex. 25, 6.) Allowing ComEd to recover 102.9% also allows ComEd to recover close to market-level compensation. (ComEd Ex. 18.0 REV, 4-5; ComEd Ex. 25.0, 3:42-48.)

<u>Summary of ComEd's AIP Incentive Compensation Award</u>

The ComEd AIP incentive compensation "award" is one component of total employee compensation that applies to all of ComEd's employees. (ComEd Ex. 2.0, pp. 16-17.) Employee compensation is structured by first determining market salaries for its employees and then putting a portion of that market salary "at risk" as incentive compensation (for example, 20 % at risk, AG Ex. 1.7, p. 3) if operational goals are met. As stated by ComEd witness Gary Prescott, "if ComEd employees want to earn *market-level compensation,* they need to ensure ComEd meets its operational metrics." (ComEd Ex. 18.0, p. 4 (emphasis added).)

The first part of ComEd's AIP is contingent upon ComEd performance on the eight operational goals or metrics called KPI. (ComEd Ex. 2.0, 18.) There are three levels of performance associated with each ComEd KPI: Threshold (50% funding), Target (100% funding), and Distinguished (200% funding). (ComEd Ex. 2.01, p. 3.) Performance under each of the eight KPIs is weighted to determine the Total ComEd KPI Performance. (AG Ex. 1.7, p. 7.) Thus, while employee compensation is structured based on market salaries, the AIP provides compensation significantly over market salaries (i.e., as much as 200% of an employee's target incentive opportunity, for the Distinguished level) depending on the Company's performance with respect to the eight operational metrics.

The second part of the AIP is the SPF, which relies on a reference to Exelon's EPS and is described on page six of the Exelon 2013 AIP informational guide ("AIP Guide") as follows:

> The AIP includes a feature that limits payout for Operating Company and Business Unit KPIs based upon EPS performance. Under this feature:
> - The composite payout on Operating Company / Business Unit KPIs cannot exceed the EPS performance payout level by more than 20 percentage points.
> - Threshold or higher EPS performance is required for any payout to occur under the AIP.

Id. The AIP Guide describes scenarios in which the amount of Operating Company (e.g., ComEd) AIP payout percentage changes as Exelon EPS performance and operating performance (as measured by the total Company KPI) vary. Id. Similar to scenarios set forth within the AIP Guide, the actual 2013 ComEd AIP incentive compensation "award" *actually paid* to employees and included in the revenue requirement was limited "[b]ecause Exelon's EPS did not meet a certain level above target." (ComEd Ex. 12.0 REV, p. 6.) ComEd states that theoretically, ComEd employees may "not receive any AIP because Exelon failed to meet a certain level of earnings." Id. at 7. ComEd also states "Exelon earnings per share below a threshold level will reduce the AIP award to zero." (Staff Ex. 8.0, Attachment B.)

ComEd explains that its AIP incentive compensation expense is the result of a two-step process wherein (1) the ComEd AIP "award" is "funded/earned" through meeting operational metrics, and (2) the ComEd AIP "award" payout may be limited by Exelon EPS. (ComEd Ex. 12.0 REV, p. 6.) Thus, the final AIP award paid to employees takes into account both the total ComEd KPI performance associated with operating metrics *and* the achieved level of Exelon EPS performance. Regardless of the level to which the ComEd AIP incentive compensation award is "earned" or "funded" by KPI performance, the ultimate determination as to the amount of the ComEd AIP incentive compensation paid to ComEd employees and to be included in the revenue requirement is the application of the Exelon EPS component of the SPF.

Illustration of the SPF Impact on AIP Incentive Compensation Expense

The SPF is applied to determine the incentive compensation award paid to ComEd employees. It is important to understand how the SPF operated in 2013 in order to understand how the SPF is applied. There are three key elements to the SPF: the threshold Exelon EPS, the target Exelon EPS and the actual Exelon EPS. In 2013, the Exelon EPS threshold amount was $2.22, the Exelon EPS target amount was $2.49, and the actual Exelon EPS was reported as $2.50. (Staff Ex. 8.0, Attachment E.) Total ComEd KPI performance percentage for 2013 was reported as 140.4%. Id. These amounts are used in the table and paragraphs below to help illustrate how the SPF is applied in the determination of ComEd AIP incentive compensation and how it was applied in 2013. (Staff Ex. 8.0, pp. 19-20.)

Table 1.

Actual EPS (A)	**Actual EPS Percentage**[8] (B)	**SPF Tolerance** (C)	**SPF Max AIP Payout** (D=B+C)	**Actual ComEd KPI Performance** (E)	**ComEd AIP Final Payout** (F=lesser of D or E)
< $2.22	0%[9]	0%	0.0%	140.4%	0.0%
$2.30	64.8%	20%	84.8%	140.4%	84.8%
$2.50	104.4%	20%	124.4%	140.4%	124.4%
$2.67	178.3%	20%	198.3%	140.4%	140.4%

Using the 2013 EPS amounts above, if actual Exelon EPS is less than the threshold Exelon EPS of $2.22, then the ComEd AIP incentive compensation paid to employees and included in the revenue requirement is zero. This scenario is true regardless of the level of performance reached for the ComEd AIP KPI. (Staff Ex. 8.0, Attachment B.) Stated differently, unless Exelon's EPS exceeds $2.22, ComEd employees receive no AIP payment, even if the KPI metrics are met or exceeded. (Staff Ex. 8.0, p. 20.)

In the scenario where Exelon's actual EPS is $2.30, above the $2.22 threshold but below the $2.49 target amount, then the ComEd AIP incentive compensation award paid to employees increases from zero in the previous example to a maximum of 84.8%. Although ComEd's performance relative to its KPIs would have resulted in a ComEd AIP incentive compensation payout of 140.4% without the SPF, the payout is

[8] EPS Percentages are interpolated between Threshold (50%) and Distinguished (200%) levels of performance. *See* Staff Exhibit 8.0, Attachment F.
[9] Threshold or higher EPS performance is required for any payout to occur. *See* AG Ex. 1.7, 7.

limited to 84.8% through the application of the SPF in this example. (Staff Ex. 8.0, pp. 20-21.)

In the scenario where Exelon's actual EPS is $2.50, above both the $2.22 threshold and the $2.49 target amount (as was the case in 2013), then the ComEd AIP incentive compensation award paid to employees increases from 84.8% in the previous example to a maximum of 124.4%. Although ComEd's performance relative to its KPIs would have resulted in a ComEd AIP incentive compensation payout of 140.4% without the SPF, the payout is limited to 124.4% through the application of the SPF. (Staff Ex. 8.0, p. 21.)

Finally, in the scenario where Exelon's actual EPS is $2.67, then the SPF limit on ComEd AIP paid to employees rises to 198.3%. The ComEd AIP cannot exceed the total ComEd KPI Performance percentage (which is 140.4% in this example), as such, the SPF limit has no effect on the ComEd AIP incentive compensation payout under this scenario. (Staff Ex. 8.0, p. 21.)

<u>Statutory Construction and Legal Argument</u>

The recovery of incentive compensation expense is specifically addressed under the performance-based formula rate legislation. Section 16-108.5(c)(4) and (c)(4)(A) provide that the performance-based formula rate approved by the Commission shall among other things:

> (4) <u>Permit and set forth protocols</u>, **subject to a determination of prudence and reasonableness consistent with Commission practice and law**, for the following:
> (A) recovery of incentive compensation expense that is based on the achievement of operational metrics, including metrics related to budget controls, outage duration and frequency, safety, customer

> service, efficiency and productivity, and environmental compliance. **Incentive compensation expense that is based on net income or an affiliate's earnings per share shall not be recoverable under the performance-based formula rate**;

220 ILCS 5/16-108.5(c)(4)(A)(emphasis added).

It is Staff's position that "expense" or "expenses" means costs flowing through the Company's income statement. Specifically, incentive compensation "expense" from an accounting perspective in the context of formula rate determinations means the operating expenses that are largely reflected in the Company's FERC Form 1 or that are otherwise reflected in the Company's books and records. (Staff Ex. 8.0, p. 22.) ComEd agrees with Staff, stating "expense" means what is recorded on the Company's financial statements. (Tr. 150:11-15, Aug. 27, 2014.) ComEd further confirms that the ComEd AIP expense recorded in the financial statements is the total ComEd AIP payout. (Tr. 150:16-151:7, Aug. 27, 2014.) Past Commission practice has been to treat capitalized incentive compensation costs in parallel with its treatment of incentive compensation expense. (Staff Ex. 8.0, p. 22.)

The phrase "based on," which appears in two places in Section 16-108.5(c)(4)(A) and again in 16-108.5(c) ("The utility shall file, together with its tariff, final data based on its most recently filed FERC Form 1, …"), is not defined. The Merriam Webster dictionary defines the verb "base" as follows: to find a basis <she based her argument against the death penalty on careful research>. Synonyms of the verb "base" are identified as follows: ground, hang, predicate, rest. While Staff views this definition as supportive of its view that the SPF determines the amount of incentive compensation paid and therefore the incentive compensation expense rests upon the SPF, Staff recognizes that the verb "base" has some ambiguity in this context. Clearly, however, ComEd's AIP payout is contingent upon Exelon achieving a particular EPS in the same way that ComEd's formula rates are contingent upon ComEd's FERC Form 1 data. ComEd's use of the Shareholder Protection Feature which relies on Exelon's earnings per share is contrary to Commission Orders discussed below that have adopted a policy of disallowing incentive compensation expenses that rely on the financial performance of the public utility or its affiliate. Id. at 32.

EIMA and Incentive Compensation Recovery

ComEd witness Ms. Brinkman states, "Nothing in EIMA precludes limiting the payout of incentive compensation awarded under operational metrics by reference to measures of the company's financial condition." (ComEd Ex. 12.0 REV, p. 4.) Ms. Brinkman's statement implies that EIMA addresses the situation she describes, which it does not. EIMA would appear to permit incentive compensation plans that reward the achievement of operational goals provided that such plans are prudent and reasonable and consistent with Commission practice. EIMA does not appear to address hybrid plans, such as the ComEd AIP at issue here, which "limit[] the payout of incentive compensation awarded under operational metrics by reference to measures of the company's financial condition." Id. Instead, Section 16-108.5(c)(4)(A) of EIMA prohibits recovery by ratepayers of incentive compensation expenses if such expenses are "based on" affiliate earnings per share or net income, both clearly "measures of the company's financial condition." Id.

Further, Ms. Brinkman states, "ComEd's AIP could not have been based on Exelon earnings because no matter how high Exelon's earnings were in 2013, those earnings did not and could not increase ComEd's total payout." (ComEd Ex. 18.0, p. 6.)

Ms. Brinkman's statement is a simply a play on words for two reasons. First, Ms. Brinkman's statement relies on her assertion that the AIP is "earned" and "awarded" prior to the SPF is applied. As discussed above, no payout occurs, and none is earned or awarded, until the SPF determines the incentive compensation payout. Ms. Brinkman, relying on these assertions, interprets the statutory prohibition in Section 16-108.5(c)(4)(A) against recovery from ratepayers of incentive compensation expense based on earnings to apply only if recovery of the "earned" or "awarded" incentive compensation would result in an *increase* in that award. There is nothing, however, in the EIMA which supports this conclusion. While it is true that ComEd's AIP payout will not increase past a certain point defined in the plan regardless of how high Exelon's EPS is, it is Exelon's earnings which determine the AIP payout and if Exelon's earnings in 2013 were too low, however, ComEd's AIP payout would have been zero.

Second, Ms. Brinkman, like ComEd witness Mr. Brookins, ignores the simple fact that ComEd's AIP is determined by reference to Exelon's earnings. ComEd witness Mr. Brookins inaccurately states, "All of ComEd's AIP expense is strictly related to ComEd operational and cost control metrics, and these are the metrics." (ComEd Ex. 19.0, p. 5.) In actuality, while ComEd uses the eight operational KPIs to make an initial or threshold determination as to whether its employees are *eligible* to receive incentive compensation in any particular year, to determine the AIP payout, ComEd then must apply the SPF, which is entirely based on Exelon EPS and always serves to determine the existing payout or "expense." It is simply untrue that *all* of ComEd's AIP expense is strictly related to ComEd operational and cost control metrics. Because the amount ComEd is seeking to recover for 2013 used the SPF, which is Exelon's earnings per share, ComEd's expense appears to be (in accordance with the above definition of the verb "base") "based on" an affiliate's earnings per share, in contravention of Section 16-108.5(c)(4)(A).

Commission's Practice Regarding Incentive Compensation

The Commission has on multiple occasions considered the recovery of incentive compensation costs from ratepayers. The prior Commission practice, affirmed by the Appellate Court, has been to disallow incentive compensation where ratepayers received no benefit or questionable benefit:

> For the most part, the Commission agrees with Staff. Incentive compensation related to financial goals, affiliate goals or shareholder goals should not be recoverable from ratepayers.
>
> *******
>
> This long line of Commission precedent was recently affirmed. In ComEd's appeal of the Commission's decision in Docket 05-0597, the court stated that "there is ample precedent making a benefit to ratepayers a condition upon which the recovery of salary-related expense depends" *ComEd Appeal* at 12. The Commission's decision here conforms to this standard.…
>
> Moreover, the *ComEd Appeal* found that attracting good employees was too remote a benefit for ratepayers to support recovery from ratepayers. *ComEd Appeal* at 13.

(ICC Docket Nos. 09-0166/0167 Cons. (Order, January 21, 2010) p. 58-59 (emphasis added).[10])

The Commission also addressed this issue in a ComEd Energy Efficiency reconciliation docket, Docket No. 10-0537.

[10] The above referenced *ComEd Appeal* refers to the decision of the Appellate Court of Illinois Second District ruling in Commonwealth Edison Company ("ComEd") Docket No. 05-0597 filed September 17, 2009. ComEd v. ICC et al., 398 Ill. App. 3d 510, 924 N.E.2d 1056, Ill. App. 2nd Dist., 2009

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> This Commission has long required a showing of benefit to ratepayers due to AIP to recover incentive compensation cost. In this Docket, the Company had failed to show how the incentive cost it sought to recover relate to energy efficiency or how the AIP had been tailored for ComEd's EE employees.

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ICC Docket No. 10-0537 (Order, October 17, 2012) p. 24 (emphasis added).

Further, the Commission previously denied rate recovery of incentive compensation when payout of the non-financial performance goals was dependent upon achievement of financial goals. For example, the Commission denied rate recovery of 100% of Illinois-American Water Company's annual incentive plan costs including non-financial performance goals since the payout under the AIP was dependent on the utility's parent company reaching its financial earnings goals. (ICC Docket No. 07-0507 (Order, July 30, 2008) pp. 25-26.) The Commission stated in part:

> However, there is no dispute that all payments under the AIP are dependent on American Water, the parent company of IAWC, reading a certain financial target. …
> The Commission, however, does object to the notion that ratepayers should have to help encourage IAWC's employees to meet goals benefitting shareholders to meet minimum service obligations.

(ICC Docket No. 07-0507 (Order, July 30, 2008) p. 26.)

In Docket No. 07-0566 concerning ComEd, the Commission disallowed 100% of ComEd's Annual Incentive Plan ("AIP") net income goals.

> Regarding ComEd's AIP's Net Income Metric, the Commission agrees with Staff's proposed adjustment disallowing 100% of AIP costs related to the financial net income goal which primarily benefits shareholders. ComEd's net income goals are financially based and primarily result in shareholder benefits. The Commission has repeatedly held that the cost of financial goals should not be paid by ratepayers.

(ICC Docket No. 07-0566 (Order, September 10, 2008) p. 61.)

In adopting Staff's adjustment in Docket No. 07-0566 the Commission agreed with Staff's concern, among other things, that a financial based metric introduces an inappropriate circular relationship between rates and the expenses such rates are designed to recover: the larger the rate increase granted the more success ComEd will have in achieving its earnings, *i.e.*, net income, goal.

In a Nicor rate case, Docket No. 08-0363, Nicor agreed to remove the costs of all its financially based plans except one, the Incentive Compensation Units ("ICU") plan. The Commission concluded that the ICU plan too was tied to financial goals and denied cost recovery of the ICU expense:

> Although the ICU Plan was created and administered in accordance with Commission policies, the Commission finds that the evidence does not demonstrate that the costs related to the Company's ICU Plan are just and reasonable. The plan is no longer in effect and payout under the Plan is tied to financial goals. Recent Commission orders have set forth the requirements that incentive compensation plans demonstrate tangible benefits to ratepayers, and that incentive compensation not be based on shareholder goals.

(ICC Docket No. 08-0363 (Order, March 25, 2009) p. 28.)

The Commission further elaborated on its policy to deny recovery of costs for goals based on achievement of financial metrics in its Ameren Order, Docket Nos. 07-0585 et al. (Cons.):

> If during the period that the rates approved herein are in effect, however, the incentive compensation plans are revised such that financial goals of Ameren become the payment trigger for a greater portion of the plans, the Commission will not look favorably on incentive compensation expenses in AIU's next rate cases. The Commission is allowing AIU to recover 50% of its incentive compensation expenses with the understanding that at least 50% of the payments made thereunder will be based on performance or goals other than Ameren's financial goals.

(ICC Docket Nos. 07-0585/07-0586/07-0587/07-0588/07-0589/07-0590 (Cons.), (Order, September 24, 2008) p. 108.)

Older Commission orders reflect similar conclusions. In Docket No. 93-0183 concerning Illinois Power Company, the Commission concluded that, since financial goals benefit shareholders, ratepayers should not have to bear the costs of incentive compensation plans tied to financial goals:

> Two of the goals, earnings per share and reduced O & M expenses are goals that benefit shareholders. If the shareholders are the ones to benefit, they should be the ones who foot the bill.

(ICC Docket No. 93-0183 (Order, April 6, 1994) p. 52.)

And, in Docket No. 99-0534 concerning MidAmerican Energy Company, the Commission reached a similar conclusion regarding ratepayer benefit from incentive compensation based on financial goals:

> The Commission is not convinced that the ratepayers are protected in the event that the targeted return on capital investment is not achieved. Ratepayers would still fund the projected levels of incentive compensation even if that level is not achieved.

(ICC Docket No. 99-0534 (Order, July 11, 2000) p. 9.)

Other examples of the Commission's disallowance of incentive compensation dependent on financial performance are from Peoples Gas and North Shore Gas ICC Order Docket Nos. 11-0281/11-0281 (Cons.), 54 (January 10, 2012) and ICC Order Docket Nos. 12-0511/12-0512 (Cons.) (June 18, 2013); Northern Illinois Gas Co., ICC Order Docket No. 08-0363, 28 (March 25, 2009); and Ameren Illinois Co., ICC Order Docket No. 07-0575 et. al., 106-108 (September 24, 2008).

In summary, the Commission's past practice has been to reject incentive compensation which is based on the financial performance of the public utility or its affiliate because ratepayers receive no appreciable benefit. In that case, shareholders are primarily benefitted by the financial performance of the public utility or its affiliate and should, therefore, bear the cost of such compensation. In addition, the Commission has agreed that incentive compensation that relies on financial performance of a company or its affiliate may create incentives for a public utility to seek a larger rate increase which would be detrimental to ratepayers.

With regard to the Commission's treatment of AIP incentive compensation in formula rate proceedings, the Commission has not specifically assessed AIP incentive compensation since its Order in ComEd's initial formula rate proceeding, Docket No. 11-0721. In that Order, the Commission adopted Staff's AIP incentive compensation cap (limiter) of 102.9%, stating:

> At the outset, the Commission disagrees with ComEd's characterization of what was decided in its last rate case as a finding that these two programs were beneficial to ratepayers. A review of the final order in Docket 10-0467 indicates only that there was no evidence to disqualify these programs, which is not the same thing as a finding that something is beneficial. (*See,* Docket 10-0467, Final Order of May 24, 2011, at 70-74). The Commission further notes that without some sort of cap on these programs, as Staff, CUB/City, and AG/AARP point out, there can be manipulation on the part of management at ComEd between the two programs without any real accountability to ratepayers as to what the employees actually did to earn incentive compensation benefits.
>
> **…**
>
> The Commission does, however, find that a cap on incentive compensation benefits that are recoverable through rates is necessary, given the potential for manipulation between the two incentive compensation programs. **The Commission therefore adopts Staff's cap of 102.9% for any incentive program. Doing so allows for some growth in incentive compensation for ComEd's employees, while placing a damper on the ability of ComEd's management to**

> **manipulate the caps on these programs in a manner that increases rates without evidence that adequate benefits flow to ratepayers.**

Commonwealth Edison Co., ICC Order No. 11-0721, 90 (May 29, 2012) (emphasis added). Aff'd in Commonwealth Edison Co. v. Illinois Commerce Comm'n, 2014 IL App (1st) 122860.

In Docket No. 12-0321, ComEd's AIP was not a contested issue. Thus, the AIP costs included in the revenue requirement were approved without Staff or Commission comment. The Order does not identify the total Company KPI performance or cap, if any, reflected in the AIP cost. Commonwealth Edison Co., ICC Order No. 12-0321, 31-32 (December 19, 2012).

In Docket No. 13-0318, although ComEd's AIP included an Exelon EPS limiter similar to that found in this proceeding, the Company proposed, and the Commission approved, a *pro forma* adjustment which reduced the AIP incentive compensation down to the 102.9% limit adopted by the Commission in its 11-0721 Order. (*See*, Docket No. 13-0318, ComEd Ex. 3.0, 39-40 *stating* "Per the Commission's order in ICC Docket No. 11-0721, (*see Commonwealth Edison Co.,* ICC Docket No. 11-0721 (Order May 29, 2012) at 90), ComEd reduced its actual amount of AIP incurred in 2012 to conform to the incentive compensation cap of 102.9% […]") The AIP itself was again not specifically addressed by Staff or the Commission. Commonwealth Edison Co., ICC Order No. 13-0318 (December 18, 2013).

ComEd argues that the Commission has not previously taken issue with the SPF or other EPS or Net Income related limiters and approved AIP incentive compensation that included the SPF as a component of the AIP design in its Order in recent ComEd proceedings including Docket No. 13-0318. (ComEd Ex. 25.0, pp. 4-5.) However, this argument rings hollow and a similar argument by ComEd has been previously rejected by the Commission ("This docket is the first time the issue of AIP cost recovery has been brought to the Commission's attention by Staff in a ComEd Rider EDA reconciliation proceeding. Therefore, the argument that AIP incentive compensation costs may have been previously recovered from ratepayers through ComEd's Rider EDA is not a valid reason for the recovery of the AIP costs in this reconciliation proceeding." (ICC Docket No. 10-0537 (Order, October 17, 2012) p. 24).) As ComEd stated in this proceeding, limiting AIP to 102.9% effectively negates the SPF component of the ComEd AIP design. (ComEd Ex. 25.0, 6:122-123. Further, notably absent from the Company argument is specific reference to where any of its prior ComEd Orders the Commission explicitly stated its approval of net income or EPS limiters. Any argument that the absence of adjustment to, or discussion of, net income or EPS limiters in prior ComEd Orders is binding on the current proceeding are ineffective, as the decision to allow or disallow recovery of incentive compensation in the current proceeding must be made pursuant to an evaluation of the evidence in this proceeding. The Commission has "the authority to address each matter before it freely, even if it involves issues identical to a previous case." <u>Lakehead Pipeline Co. v. Illinois Commerce Comm'n</u>, 296 Ill. App. 3d 942, 956 (3d Dist. 1998). Further, the approval of a revenue requirement in absence of the discussion of all of its components does not provide implicit approval of every cost included in the development of the approved revenue requirement. The Commission need not make a finding on each issue or evidentiary fact. Instead, the Commission is required to make findings only as to those facts which are essential to its determination. Citizens Utilities Co. v. Illinois Commerce Comm'n, 49 Ill. 2d 458, 463 (1971).

AIP as a Component of Market Compensation

ComEd witness Mr. Prescott states:

> The incentive compensation method is superior because it provides more value to ComEd and its customers by ensuring that employees must meet and exceed certain operational goals before they receive their total compensation. Incentive compensation also improves productivity and performance and increases customer benefits.

(ComEd Ex. 18.0, p. 5.) He further states, "Pay at risk directly ties compensation to performance – if employees want to earn market-level compensation, they need to ensure that ComEd meets its operational metrics." Id. at 4. While it may be true that each incentive compensation plan must be reviewed on its terms to ensure that employees are being incented appropriately to meet goals that provide useful and appreciable benefits to customers and in reasonable amounts, it is also true that ComEd's AIP can also create certain disincentives for some employees, particularly in years when Exelon's earnings are low or volatile. (Staff Ex. 8.0, 30.) Mr. Prescott's argument that pay at risk programs tie compensation to performance is overstated. The ComEd AIP is structured by first determining market compensation for ComEd employees and then putting a portion of that market compensation "at risk" as incentive compensation if operational goals are met. Id. The AIP, however, provides incentive compensation which allows for total compensation significantly over market salaries (AIP as much as 200% of an employee's target incentive opportunity, if the Exelon EPS limiter is excluded and not including individual employee multipliers which may increase the individual's AIP) depending on the Company's performance with respect to the eight operational goals. Due to ComEd's SPF, if Exelon's EPS is below a threshold EPS, employee performance is irrelevant. High performers and low performers alike miss out on AIP and fail to receive their targeted market compensation. Therefore, there is no incentive for employees to work to “increase customer benefits” if the employees know that ultimately, their performance is not the determining factor in whether they receive the AIP incentive compensation payout. Id. at 30-31. This may be especially likely in a year when employees are aware that the Exelon EPS is known to be consistently low. Despite ComEd’s assertions that “ComEd’s employees are not informed about Exelon’s EPS,” these assertions are not credible as the Exelon EPS is obtainable on a daily basis by a simple Google search or scan in the newspapers’ stock pages. (ComEd Ex. 32.0, 3:45; Tr. p. 329:14-22, August 28, 2014.)

Additionally, the SPF relies on the EPS of ComEd’s parent, Exelon. Thus, if ComEd employees meet or exceed the operational KPIs, but PECO or another affiliate has a poor year, Exelon’s EPS may be below the threshold amount. ComEd’s employees receive limited or zero AIP payout due to forces entirely outside of their control. While employees do not have official word until the end of the year as to Exelon’s EPS, a low earning or volatile EPS may be tracked by employees unofficially. Therefore, such employees would have less incentive to work hard in order to achieve the operational metric goals. While ComEd’s witnesses emphasize that the AIP program benefits ratepayers, this is simply unclear particularly in connection with ComEd’s hybrid AIP program. (Staff Ex. 8.0, p. 31.)

Finally, despite ComEd’s repeated claims that the AIP is compensation, not a bonus, employees receiving over 140% of at risk pay certainly seems more akin to a bonus than regular salaried compensation. (ComEd Ex. 2.0, 17:339-340; Tr. 137:2-

138:2, August 27, 2014.) It is unclear whether it is reasonable for ratepayers to pay for ComEd employees to receive 140% of market-based at risk pay, especially when individual performance is not taken into consideration for a substantial number of ComEd's employees. As ComEd witness Brinkman confirmed, ComEd employees that operate under a collective bargaining agreement (over 50% of ComEd's employees)[11] will still receive the full AIP payout if they are personally underperforming. (Tr. 148:13-19.) It is unreasonable for ratepayers to pay for 140% of ComEd employees' at risk compensation if those employees perform poorly.

Staff's Alternative Position

For all of the foregoing reasons, Staff's views the ComEd AIP expense as contrary to both the law and Commission practice. As an alternative to disallowing 100% of the ComEd AIP,as noted earlier in Docket No. 11-0721, when the Commission found the Company's AIP to be problematic given the potential for manipulation, it did not disallow 100% of ComEd AIP:

> The Commission does, however, find that a cap on incentive compensation benefits that are recoverable through rates is necessary, given the potential for manipulation between the two incentive compensation programs. **The Commission therefore adopts Staff's cap of 102.9% for any incentive program. Doing so allows for some growth in incentive compensation for ComEd's employees, while placing a damper on the ability of ComEd's management to manipulate the caps on these programs in a manner that increases rates without evidence that adequate benefits flow to ratepayers.**

Commonwealth Edison Co., ICC Order No. 11-0721, 90 (May 29, 2012)

[11] *See* ComEd Ex. 18.0 REV, pp. 7-8:137-145, stating that of the approximately 6000 ComEd employees, approximately 3700, or over 50%, are union employees.

Staff also recognizes this issue is a tough one because the disallowance of 100% of the incentive compensation expense includes expenses for the market value component of employee salaries that would typically be recoverable. Therefore, it may be more equitable to allow legitimate salary expenses to be recoverable. Further, although incentives are mixed in this hybrid plan, the AIP appears to produce some incentive for employees to satisfy legitimate operational metrics that benefit ratepayers. Thus, in the event the Commission does not agree that all of the AIP payout should be disallowed, the Commission could consider allowing ComEd to recover the same level of Company KPI performance of 102.9% that the Commission authorized in Docket No. 11-0721 which would result in recovery of 100% of the fair market value of employees' salaries plus a small, reasonable bonus. Staff would be comfortable with this decision.

This alternative would result in an adjustment of approximately $(6,104,000) to the operating statement and $(4,006,000) to rate base. (ComEd Ex. 25.01.) Further, similar to its impact on the 2012 ComEd AIP incentive compensation expenses ultimately allowed in ComEd's prior formula rate proceeding, Docket No. 13-0318, the alternative 102.9% limiter proposed in this proceeding effectively negates any impact of the controversial EPS-based SPF on 2013 ComEd AIP incentive compensation. (ComEd Ex. 25, 6.) Allowing ComEd to recover 102.9% also allows ComEd to recover close to market-level compensation, in addition to being consistent with past Commission practice. (ComEd Ex. 18.0 REV, 4-5; ComEd Ex. 25.0, 3:42-48.)

b. Key Manager Long Term Performance Plan ("LTPP")

City/CUB/IIEC witness Mr. Gorman proposes a 100% disallowance of the LTPP costs because employees who are eligible for this plan are also eligible for the AIP and because in his view the reliance on the same AIP metrics results in ComEd ratepayers paying twice for achieving the same performance goals. (City/CUB/IIEC Ex. 1.0, pp. 11-12.) Staff does not recommend that the Commission adopt this adjustment.

The ComEd LTPPP incentive compensation award is one component of total employee compensation that applies only to key managers and mid-level management employees. (ComEd Ex. 2.0, p. 25.) The LTPP is contingent upon performance towards the same eight metrics utilized within the ComEd AIP. LTPP is paid at 100% if performance towards the LTPP metrics meets or exceeds 100% and no payout is made in the event that LTPP performance is less than 100%. Id. In Staff's view, while the metrics may be the same between the AIP and LTPP programs, the programs are different in that (1) the metrics are not weighted the same (AIP KPI performance is calculated as a weighted average, while LTPP KPI performance is calculated as a simple average) and (2) AIP is a short term incentive plan, whereas LTPP is a long term plan. Further, use of similar operational metrics places even more emphasis on the achievement of metrics that provide ratepayer benefits. (Staff Ex. 8.0, pp. 37-38.)

c. Long-Term Performance Share Awards Program ("LTPSAP")

The Commission should adopt AG witness Mr. Brosch's adjustment to disallow 100% of Long Term Performance Share Awards Program ("LTPSAP") incentive compensation expense. The ComEd LTPSAP incentive compensation award is one component of total employee compensation that applies only to upper management employees. (ComEd Ex. 2.0, p. 14.) The first part of the LTPSAP is contingent upon performance towards six individual metrics. (ComEd Ex. 2.1, p. 13.) The second part of the LTPSAP is the application of the Total Shareholder Return ("TSR") modifier. Id. In 2013, the LTPSAP award was limited at the discretion of the Compensation Committee of the Exelon Board of Directors. (AG Ex. 1.0, p. 27.)TSR "is a standard measure of the performance of a company's stock over time." (AG Ex. 1.8.) It represents a composite of share price appreciation and dividends paid, expressed as an annualized percentage. The TSR is compared to the average TSR performance of an Exelon peer group and the variance of Exelon's TSR from the average TSR determines the LTPSAP TSR modifier. The TSR modifier acts to adjust the LTPSAP award by up to plus or minus 25%. (ComEd Ex. 2.01, p. 13.) The TSR modifier did not impact 2013 LTPSAP. (AG Ex. 1.8.)

ComEd removed 86.5% of the LTPSAP costs as being associated with non-allowable financial metrics. (ComEd Ex. 2.0, 27.) City/CUB/IIEC witness Mr. Gorman proposed a partial disallowance of the remaining 13.5% LTPSAP costs because only one third of the remaining award was based on ComEd's performance. (City/CUB/IIEC Ex. 1.0, pp. 10-11.) AG witness Mr. Brosch proposed to disallow 100% of the LTPSAP because (1) the remaining award was not based solely on ComEd's operational performance and (2) the LTPSAP involves subjective high level modifications due to the limits imposed by the Compensation Committee of the Exelon Board of Directors. (AG Ex. 1, pp. 26-27.)

Staff agrees that only a portion of the LTPSAP amount being sought for recovery by ComEd is related to ComEd operational performance. ComEd's rebuttal testimony reduces the amount of recovery it is seeking for LTPSAP accordingly. (ComEd Ex. 12.0, p. 11.) As explained further below, however, the remaining LTPSAP costs are dependent, in part, on financial measures of the type that the Commission has disallowed in previous proceedings. The Compensation Committee reduced the LTPSAP payout “to better align the payout with shareholder returns, taking into consideration that Total Shareholder Return was down for the year.” (Staff Ex. 8.0, Attachment G.) Shareholder return is a financial measure similar to the type that the Commission has disallowed in previous proceedings.

As cited in Staff’s arguments regarding AIP incentive compensation above, the Act precludes performance-based formula rate recovery of incentive compensation expense that is based on net income or an affiliate’s EPS. The Act also subjects the recovery of incentive compensation to the restriction that such recovery must be consistent with Commission practice and law and be prudent and reasonable. For the same reasons as discussed regarding AIP above, the LTPSAP incentive compensation expense is not recoverable as the expense amount is based on the achievement of financial measures similar to net income and affiliate EPS which the Commission has on several occasions disallowed. As discussed in Staff’s arguments regarding AIP incentive compensation above, the Commission has on several occasions disallowed incentive compensation costs that are based on financial performance. In addition, the Commission has disallowed incentive compensation based on financial measures in prior ComEd proceedings. For example, in Docket No. 07-0566, the Commission disallowed the portion of ComEd AIP incentive compensation that was based upon a net income goal and disallowed the portion of the Long-Term Incentive Plan that was based upon financial goals. (Commonwealth Edison Co., ICC Order No. 07-0566, 61 (September 10, 2008).) Further, the Commission’s Order in Docket No. 05-0597 also disallowed ComEd incentive compensation based on an EPS financial measure. Commonwealth Edison Co., ICC Order No. 05-0597, 95-97 (July 26, 2006).

3. Collection Agency Costs

The Commission should adopt Staff's adjustment to remove from the revenue requirement collection agency costs associated with Purchase of Receivables/ Combined Billing ("PORCB") service and with ComEd supply service. These costs should be excluded from the revenue requirement and should be recovered as appropriate through Rider PORCB and through Rider PE – Purchased Energy ("Rider PE") (and associated Rate BESH). The associated Rider PORCB and Rider PE tariff changes set forth in ComEd Ex. 13.09, 13.10, and 13.11 should likewise be approved. (Staff Ex. 8.0, pp. 6-7.) Finally, the Commission should approve Staff's proposal regarding ComEd's request for an affirmative finding regarding the appropriate recovery mechanism for certain collection agency costs, and find in its Order in this proceeding that:

1. Collection agency costs associated with the provision of PORCB service should be recovered through ComEd Rider PORCB; and
2. Collection agency costs associated with ComEd supply should be recovered through ComEd Rider PE.

(Staff Ex. 2.0, pp. 12-13.)

ComEd proposed to recover collection agency costs associated with delivery service and with providing PORCB service in its delivery service revenue requirement. ComEd stated that the remaining collection agency costs can be attributed to ComEd supply and should be recovered through Rider PE. (ComEd Ex. 3.0, p. 33.) Further, ComEd requested an affirmative statement from the Commission regarding where these collection agency costs should be appropriately recovered. Id. at 33-34.

The collection agency costs associated with PORCB service should not be recovered through delivery service rates. Section 16-118(c) of the Act states the utility shall purchase receivables at a just and reasonable discount rate and that the discount rate shall be based in part on administrative costs associated with PORCB service. 220 ILCS 5/16-118(c). Collection agency costs associated with PORCB service are an administrative cost that would not be incurred if not for ComEd's provision of PORCB service. Thus, such collection agency costs are an administrative cost associated with PORCB service. Ultimately all costs associated with the provision of PORCB service are to be recovered from Retail Electric Suppliers ("RESs"). (Commonwealth Edison Co., ILL. C. C No 10, 2nd Revised Sheet No. 393.) Thus, it would be inappropriate for these PORCB costs to be recovered through delivery service rates. (Staff Ex. 2.0, pp. 10-11.)

Costs associated with PORCB service in excess of those recovered from the RESs are to be recovered temporarily from retail customers in accordance with the provisions of the Purchase of Receivables Adjustment section of ComEd Rider RCA – Retail Customer Assessments ("Rider RCA"). (Commonwealth Edison Co., ILL. C. C No 10, 2nd Revised Sheet No. 399.) At such a time that the total historical amounts recovered from the RESs via Rider PORCB exceed the total historical costs associated with the provision of PORCB service, the excess is to be refunded back to retail customers in accordance with the provisions of the Purchase of Receivables Adjustment section of Rider RCA, to provide reimbursement to such retail customers for amounts previously recovered from such retail customers for accrued costs associated with PORCB service. Id. Under this approach, all costs associated with the provision of PORCB service are ultimately recovered from the RESs and not retail customers. (Staff Ex. 2.0, p. 11.)

Under ComEd's proposal to include collection agency costs associated with PORCB in the delivery services revenue requirement, collection agency costs associated with PORCB service would ultimately be recovered from all retail customers rather than being recovered from the RESs who are ultimately responsible for all costs associated with PORCB service. Therefore, collection agency costs associated with PORCB service should be considered under Rider PORCB rather than be included in the delivery services revenue requirement. Id. at 11-12.

Illinois Competitive Energy Association ("ICEA") supports the ComEd proposal to recover PORCB-related collection agency costs through delivery service rates. ICEA further opines that if PORCB related collection agency costs are recovered through Rider PORCB, it would make sense that revenue from the success of the collection agency should pay down or otherwise defray the costs that are assigned to RES's. (ICEA Ex. 1.0, pp. 7-8.) ComEd agrees that revenue from the success of the collection agency should reduce the costs that are assigned to the RES's; however, as ComEd makes clear in its surrebuttal testimony, the uncollectible discount rate applied within the operation of Rider PORCB is calculated based on ComEd supply net charge-offs and already takes into account the revenue from the success of collection agencies. As such, the actual amount of uncollectibles used to determine the PORCB uncollectible discount rate is lower than it otherwise would have been if not for the successful efforts of the collection agencies, resulting in a lower cost to the RES's for uncollectibles. (ComEd Ex. 26.0, pp. 3-4.) As the revenues in question are already used to reduce the costs assigned to the RES's, the ICEA concern is unwarranted.

Staff recommends that the Commission conclude in its final Order in this proceeding that:

1. Collection agency costs associated with the provision of PORCB service should be recovered through ComEd Rider PORCB; and
2. Collection agency costs associated with ComEd supply should be recovered through ComEd Rider PE.

(Staff Ex. 2.0, pp. 12-13.) In the event that the Commission agrees with Staff's recommendations, the collection agency costs associated with PORCB service and ComEd supply service must be removed from the revenue requirement to ensure they are not recovered twice – once through the riders and once through base rates. (Staff Ex. 8.0, pp. 6-7.)

ComEd does not object to Staff's recommendation to recover through Rider PORCB the collection agency costs associated with the provision of PORCB service. Further, ComEd stated that it agrees with Staff's recommendation to recover through Rider PE the collection agency costs associated with ComEd supply service. (ComEd Ex. 13, pp. 11-13; ComEd Ex. 26.0, pp. 2-3.) In addition, ComEd set forth in ComEd Ex. 13.09 through ComEd Ex. 13.11 the tariff changes necessary to effectuate the recovery of collection agency costs through Ricer PORCB and Rider PE with associated Rate BESH. Staff agrees with and recommends Commission approval of these tariff changes. (Staff Ex. 8.0, p. 7.)

VI. RATE OF RETURN

A. Overview

Staff and the Company both recommend a 7.06% rate of return on rate base for 2015 rate setting and a 7.04% rate of return on rate base for 2013 reconciliation for ComEd's electric delivery services, based on the following capital structure and capital costs:

Filing Year:

Capital Component	Percent of Total Capital	Cost	Weighted Cost
Short-term Debt	0.22%	0.40%	0.00%
Long-term Debt	54.01%	5.16%	2.79%
Common Equity	45.77%	9.25%	4.23%
Credit Facility Fees			0.04%
Total	100.00%		7.06%

Reconciliation Year:

Capital Component	Percent of Total Capital	Cost	Weighted Cost
Short-term Debt	0.22%	0.40%	0.00%
Long-term Debt	54.01%	5.16%	2.79%
Common Equity	45.77%	9.20%[12]	4.21%
Credit Facility Fees			0.04%
Total	100.00%		7.04%

(Staff Ex. 3.0, p. 4; ComEd Ex. 3.01, Schedule FR D-1.)

B. Capital Structure

Staff and the Company agree that an end-of year 2013 capital structure comprising 0.22% short-term debt, 54.01% long-term debt and 45.77% common equity

[12] Includes a 5 basis point reduction to ComEd's return on equity as a performance metrics penalty pursuant to 220 ILCS 5/16-108.5.

(excluding goodwill) is appropriate for setting rates in 2015 and the reconciliation for 2013. Specifically, Staff agrees that ComEd's capital structure is appropriate for the reasons set forth in Docket No. 13-0318, ComEd Ex. 4.01, pp. 23-25. (Staff Ex. 3.0, p. 2.)

C. Cost of Capital Components

1. Rate of Return on Common Equity

Staff and ComEd agree that the cost of equity is 9.25% for the 2015 filing year revenue requirement and 9.20% for the 2013 reconciliation year revenue requirement. The 9.25% return equals the 3.45% monthly average 30-year U.S. Treasury bond yield, plus 580 basis points, as required under Section 16-108.5 of the Act. ComEd did not meet a service reliability target outlined in Section 16-108.5, therefore, it incurred a five basis point penalty reduction to the cost of equity applied to the reconciliation year revenue requirement. (Staff Ex. 3.0, p. 4; ComEd Ex, 5.0, p. 5.)

2. Cost of Long-Term Debt

Staff and the Company agree that a cost of long-term debt of 5.16% is appropriate for both 2015 rate setting and the 2013 reconciliation. (Staff Ex. 3.0, p. 4; ComEd Ex, 3.0, Schedule FR D-1.)

3. Cost of Short-Term Debt

The Company presented a short-term debt cost of 0.40%, which equals the weighted cost of short-term borrowings reported in the Company's 2013 Form 10-K, page 327. Nevertheless, since there was a relatively small short-term balance as of the end of the year, this does not affect the overall cost of capital. (Staff Ex. 3.0, pp. 2-4; ComEd Ex, 5.0, p. 4.)

In addition, ComEd's annual credit facility commitment fees, when divided by the total capitalization, produce a credit facility fee of 4 basis points, which should be added to ComEd's overall cost of capital. (Staff Ex. 3.0, p. 4; ComEd Ex. 3.02, p. 87.)

4. Overall Weighted Cost of Capital

Based on the above discussion, Staff recommends the Commission adopt the following capital structure, component costs, and weighted average cost of capital:

Filing Year:

Capital Component	Percent of Total Capital	Cost	Weighted Cost
Short-term Debt	0.22%	0.40%	0.00%
Long-term Debt	54.01%	5.16%	2.79%
Common Equity	45.77%	9.25%	4.23%
Credit Facility Fees			0.04%
Total	100.00%		7.06%

Reconciliation Year:

Capital Component	Percent of Total Capital	Cost	Weighted Cost
Short-term Debt	0.22%	0.40%	0.00%
Long-term Debt	54.01%	5.16%	2.79%
Common Equity	45.77%	9.20%	4.21%
Credit Facility Fees			0.04%
Total	100.00%		7.04%

VII. RECONCILIATION

A. Overview

B. Potentially Contested Issues

1. Calculation of Interest on Reconciliation Balance

VIII. REVENUES

A. Overview

B. Potentially Contested Issues

1. Billing Determinants

ComEd proposes a change to the methodology for billing determinants. Staff recommends that the Commission continue to use the methodology for billing determinants reflected by ComEd in compliance with prior Commission orders. AG witness Effron continues to advocate for the methodology previously approved by the Commission. (AG Exhibit 2.0, p. 5-6.) The methodology increases the number of customers corresponding to the Company's inclusion of plant to serve New Business plant that ComEd included in its rate design model. (<u>See</u> ComEd Ex. 10.03; Staff Ex. 9.0, p. 39.) The methodology properly matches the billing determinants used in the determination of pro forma revenues to the plant used to provide service included in rate base. The methodology used should be an adjustment to customer billing determinants only. This is the same methodology approved by the Commission in ComEd's last three formula rate cases Docket Nos. 11-0721, 12-0321 and 13-0318 which had similar facts. (Staff Ex. 9.0, p. 39.)

This billing determinant methodology first arose in the Company's initial formula rate case, Docket No. 11-0721. In that Docket the AG/AARP pointed out that if the billing determinants do not match the number of customers that are actually served by plant additions and customer growth, the revenue requirement will be collected from too few customers, resulting in the rate per customer being higher than it should be. (Order, Docket No. 11-0721, May 29, 2012, pp. 73-74.) The Commission agreed, consequently, in its Order in Docket No. 11-0721, the Commission concluded that the AG/AARP methodology adjustment to billing determinants was appropriate. Id., p. 75. Specifically, the Commission noted that "[t]he AG/AARP proposal is reasonable" and directed ComEd to "adjust its billing determinants accordingly." Id., p. 76.

The Company has provided insufficient evidence in this proceeding to justify a change in the billing determinant methodology previously approved by the Commission, nor any evidence to warrant any additional adjustment to the billing determinant methodology. Accordingly the Commission should approve the rate design calculation ComEd filed in compliance with the Commission's previous Orders cited above which reflects the previously approved methodology. (ComEd Ex. 12.0 REV, pp. 20-23; Staff Ex. 9.0, p. 39.) In its direct testimony, ComEd indicated that it had increased the customer billing determinants associated with New Business plant in the ECOSS and rate design model in this proceeding, as directed by the Commission in the 2013 FRU Order. However, ComEd in order to preserve its position on appeal, goes on to state that it takes issue with the methodology and believes the AG/AARP adjustment should not be made in this case. (ComEd Ex. 2.0, 46-48; ComEd Ex. 10.0, 7-8; ComEd Ex. 10.03.) ComEd's arguments merely point to the mechanics of the formula rate model that have not changed throughout any of the formula rate cases. Therefore, these facts have all been considered in the prior cases and ComEd's proposed change to the billing determinant methodology should be rejected again. (Staff Ex. 9.0, p. 39.)

IX. COST OF SERVICE AND RATE DESIGN

A. Overview

B. Potentially Uncontested Issues

1. Embedded Cost of Service Study

2. Distribution System Loss Factor Study

Staff witness Rockrohr supports ComEd's (1) Distribution Loss Study and (2) Secondary and Service Loss Study which the Commission ordered ComEd to perform in Docket No. 10-0467. A Distribution Loss Study quantifies and allocates the energy lost when ComEd uses its distribution system to supply customers. Staff witness Rockrohr testified that generally, ComEd determines its total distribution losses by: (a) identifying the total energy it procures for its customers; (b) identifying the energy it ultimately delivers to customers (measured by ComEd's electric revenue meters); (c) estimating its transmission energy losses (based upon a separate transmission loss study); and then subtracting the energy it delivers plus its transmission energy losses from the energy it procures. Or algebraically: [a–(b+c)]. (ComEd Ex. 9.01, 2) ComEd allocates distribution losses to customers based upon the elements of the distribution system it typically uses to supply each of seventeen customer categories. Based upon the study results, ComEd assigns each customer category a corresponding "loss factor." (ComEd Ex. 9.01, Appendix G.) When ComEd multiplies the metered energy consumption of a customer in any category by the corresponding loss factor, the product represents the approximate amount of electric energy lost on, or consumed by, ComEd's distribution system when supplying that customer. Since ComEd combines customer categories when forming Rate RDS delivery classes, some of ComEd's Rate

RDS delivery class loss factors represent a weighted combination of the loss factors listed on ComEd Ex. 9.01, Appendix G. (Staff Ex. 5.0, pp. 2-3.)

A Secondary and Service Loss Study, is limited to quantifying and allocating distribution losses that occur on only the secondary and service elements of ComEd's distribution system (i.e. it does not consider the primary distribution system). Secondary distribution elements typically consist of lower voltage conductors (typically 480 volts or below), either overhead or underground, that parallel a street, road, alley or other right-of-way, from which multiple customers and premises receive service. Service distribution elements typically consist of lower voltage conductors (typically 480 volts or below) either overhead or underground, crossing private property that serve one or more customers at a single premises. (Staff Ex. 5.0, pp. 3-4.)

ComEd historically combined losses on its secondary and service facilities and presented those losses as a single quantity within its distribution loss study. However, since ComEd may use service elements, but not secondary elements, to supply some customer categories, such as larger commercial customers, the Commission determined in Docket No. 10-0467 that ComEd should separately identify losses attributed to secondary and service elements. Id.; (Commonwealth Edison Co., ICC Order Docket No. 10-0467, 291 (May 24, 2011).) ComEd's secondary and service loss study in the instant proceeding relied upon a field survey of actual secondary and service facilities used to serve ComEd's customers - not only Single Family, Multi-Family, Multi-Family with Space heat and 0-100 kW customers, but also the following customer categories: Single Family Space Heat, Watt Hour, Medium, Large, Very Large, Extra Large, and Lighting. (Staff Ex. 5.0, p. 5.) The resulting values for secondary and service losses that ComEd proposed in this proceeding, expressed as a percent of peak load, are shown on page 5 of ComEd Ex. 9.02 and at the bottom of ComEd Ex. 9.01, Appendix C. Staff witness Rockrohr testified that the methodology that ComEd used in its 2013 Distribution System Loss Study appeared to be an appropriate means to approximate and allocate distribution losses to ComEd's customers. Id., p. 3.

Staff witness Rockrohr recommends that the Commission accept the 2013 ComEd Distribution System Loss Study and the ComEd Secondary and Service Loss Study. Additionally, he testified that since ComEd Ex. 9.02 uses a sample of actual customer loads and conductor sizes/lengths to determine the secondary and service element losses allocated to each customer category, implementing ComEd's study results should be a fair method to allocate secondary and service element losses to customers in each of ComEd's customer classes. (Staff Ex. 5.0, pp. 5-6.) He recommends that the Commission find that through ComEd Ex. 9.02, ComEd had met the requirement to separately identify losses on secondary and service elements, as he understood that Commission requirement to be in its Final Orders in Docket Nos. 10-0467 and 13-0387. Id.; (Commonwealth Edison Co., ICC Order Docket No. 10-0467, 291 (May 24, 2011); Commonwealth Edison Co., ICC Order Docket No. 13-0387, 112 (December 18, 2013).)

3. Secondary and Service Loss Study

See Section IX. B. 2. Distribution System Loss Factor Study.

X. OTHER

A. Overview

B. Potentially Uncontested Issues

1. Intercompany Receivables and Payables Management Model Document

2. Wages and Salaries Allocator Utilized in Rider PE and Rate BESH

Staff recommended that ComEd provide the wages and salaries allocator applicable to supply, including a detailed explanation of how that allocator was determined. ComEd provided data in ComEd Ex. 13.12 which demonstrates that the wages and salaries allocator applicable to supply is .44%. Staff reviewed the information provided in ComEd Ex. 13.12 and does not object to the calculation of the supply wages and salaried allocator set forth therein. As such, Staff recommends the language below be included in the Order entered by the Commission in this proceeding:

> The Commission finds that the wages and salaries allocator applicable to supply of 0.44%, as calculated in this proceeding, should be used to develop charges determined and filed with the Commission under Rider PE and Rate BESH to be effective with the January 2015 monthly billing period. Subsequent calculations of the wages and salaries allocator applicable to supply made in subsequent ComEd Formula Rate Update proceedings must be applied in the corresponding subsequent determination and filing of charges under Rider PE and Rate BESH.

(Staff Ex. 8.0, 2-3.) ComEd agrees with the inclusion of this language in the Order. (ComEd Ex. 13.0, 17-18.)

3. Reporting Requirements

a. EIMA Investments

To increase transparency, Staff recommends the Commission include in its order in this proceeding the following conclusion:

> The Commission is setting a revenue requirement in this proceeding for the recovery of $257.7 million in actual 2013 plant additions and $449.0

million of projected 2014 plant additions in compliance with Section 16-108.5. The detail of these actual and projected plant additions by categories as required by Section 16-108.5(b)(2) are as follows:

	CATEGORY	ACTUAL 2012 (In Millions)[13]	ACTUAL 2013 (In Millions)[14]	PROJECTED 2014 (In Millions)[15]	CUMULATIVE 2014 (In Millions)
(A) (i)	Distribution Infrastructure Improvements	$92.8	$128.4	$153.8	$374.9
(A) (ii)	Training Facility Construction or Upgrade Projects	2.4	0.4	0.0	2.8
(A) (iii)	Wood Pole Inspection, Treatment, and Replacement	9.4	18.7	19.9	48.1
(A) (iv)	Reducing the susceptibility of certain circuits to storm-related damage	24.6	12.6	33.4	70.6
	Total Electric System Upgrades, Modernization Projects, and Training Facilities	$129.2	$160.2	$207.1	$496.4
(B) (i)	Additional Smart Meters	$0.1	$31.7	$148.4	$180.1
(B) (ii)	Distribution Automation	37.8	60.5	62.8	161.0
(B) (iii)	Associated Cyber Secure Data Communications Network	0.0	0.0	0.0	0.0
(B) (iv)	Substation Micro-processor Relay Upgrades	7.0	5.4	30.7	43.1
	Total Upgrade and Modernization of Transmission and Distribution Infrastructure and Smart Grid Electric System Upgrades	$44.8	$97.5	$241.9	$384.2
	Total Plant Additions in Compliance with Section 16-108.5(b)(1) of the Act	$174.0	$257.7	$449.0	$880.7

[13] ComEd Ex. 5.01.
[14] *Id.*
[15] *Id.*

Since this table mirrors the information provided on ComEd Ex. 5.01, there is no disagreement on the presentation of the information.

b. Reconciliation Year Plant Additions

c. Contributions to Energy Low-Income and Support Programs

C. Potentially Contested Issues

1. Update of Exelon Business Service's Company General Services Agreement

Staff recommends that the Company update the Exelon Business Services Company ("BSC") General Services Agreement ("GSA") in its rebuttal testimony due to some provisions that contain obsolete references. (Staff Ex. 1.0, pp. 41 – 42, lines 872 – 884.)

Company witness Brinkman responds that the Company does not believe that any update is necessary because the obsolete provisions do not impact any transactions, procedures, or regulatory oversight under the GSA and because a change to the GSA would be burdensome to Exelon. (ComEd Ex. 12.0 REV, p. 18, lines 371 – 375.) The Commission should disregard Ms. Brinkman's response, and order ComEd to update the GSA for the seven reasons presented below.

First, the provisions of the GSA that provide for the authority for the allocation of costs of multi-state electric holding companies to individual operating subsidiaries are obsolete as the provisions refer to laws that are no longer effective and regulatory bodies that no longer have the stated authority. The introductory paragraphs of the GSA approved by the Commission in Docket No. 00-0295, include the following statements:

> WHEREAS, Client Companies, including EXELON CORPORATION, which has **filed for registration under the terms of the Public Utility Holding Company Act of 1935 (the "Act")** and its others subsidiaries, desire to enter into this agreement for providing for the performance by Service Company for the Client Companies of certain services as more particularly set forth herein;
>
> WHEREAS, Service Company is organized, staffed and equipped and has **filed with the Securities and Exchange Commission (the "SEC") to be a subsidiary company under Section 13 of the Act** to render to EXELON CORPORATIOIN, and other subsidiaries of EXELON CORPORATION, certain services as herein provided;

(ComEd Response to Staff DR 11.01, Attachment 1 (emphasis added).)

Exelon Corporation is no longer subject to the Public Utility Holding Company Act of 1935 ("PUHCA 1935"), however, and the Service Company is no longer registered with the SEC. The Service Company is now subject to the rules of the Federal Energy Regulatory Commission ("FERC") under the Public Utility Holding Company Act of 2005 ("PUHCA 2005"), 18 CFR 366. The PUHCA 1935 in relevant part was repealed on August 8, 2005. The PUHCA 2005 became effective February 8, 2006. Thus, the references to PUHCA 1935 and the governance by the SEC are no longer applicable. The introductory paragraphs of the GSA are not valid.

Second, Section 2 of the GSA derives its authority from Section 13 of the PUHCA 1935 which has been repealed. Section 2 states, in part:

> <u>Section 2. Services to be Provided</u>
>
> **no change in the organization of the Service Company, the type and character of the companies to be serviced, the factors for allocating costs to associate companies, or in the broad general categories of services to be rendered subject to Section 13 of the Act,** or any rule, regulation or order thereunder, shall be made unless and until the Service Company shall **first have given the SEC written notice of the proposed change** not

> less than 60 days prior to the proposed effectiveness of any such change. If, upon the receipt of any such notice, **the SEC shall notify the Services Company within the 60-day period that a question exists as to whether the proposed change is consistent with the provisions of Section 13 of the Act, or of any rule, regulation or order thereunder**, then the **proposed change shall not become effective unless and until the Services Company shall have filed with the SEC an appropriate declaration regarding such proposed change and the SEC shall have permitted such declaration to become effective.**

Id. (emphasis added).

This section concerns the rules, regulations, and orders concerning changes in the Service Company, the type and character of the companies to be serviced, the factors for allocating costs to associate companies, and the broad general categories of services to be rendered by the Service Company to its affiliates. Contrary to the provisions of Section 2, the SEC no longer provides notification as to whether any changes can become effective under Section 13 of PUHCA 1935. The GSA no longer sets forth current procedures by which changes to the type and character of companies to be serviced, changes in the factors for allocating costs to associate companies or changes in the broad general categories of services are to be declared permissible by a governing regulatory body. Section 2 is void.

Third, Section 4 of the GSA establishes that the rules for the compensation of costs to the Service Company shall be permitted by the SEC. But, the SEC no longer has regulatory authority over the Service Company. Thus, Section 4 (see below) is also void.

> Section 4. Compensation of Service Company
>
> As compensation for the services to be rendered hereunder, Client Companies listed in Attachment A hereto, as revised from time to

> time, shall pay to Services Company all costs which reasonably can be identified and related to particular services provided by Services Company for or on Client Company's behalf (**except as may otherwise be permitted by the SEC**). All other Client Companies and their affiliates and associates (see Attachment B) shall pay to Services Company charges for services that are to be no less than cost (**except as may otherwise be permitted by the SEC**), insofar as costs can reasonably be identified and related by Services Company to its performance of particular services for or on behalf of Client Company.

Id. (emphasis added).

Fourth, Section 5 of the GSA states that the determination of costs shall be consistent with the rules and regulations of the SEC. However, the parties to the GSA are no longer subject to the rules and regulations of the SEC governing compliance under the GSA. Thus Section 5 is void.

> Section 5. Securities and Exchange Commission Rules
>
> **It is the intent of the Parties that the determination of the costs as used in this Agreement shall be consistent with, and in compliance with, the rules and regulations of the SEC, as they now exist or hereafter may be modified by the Commission.**

Id. (emphasis added).

Fifth, the SEC no longer has the authority to provide the rule, regulation, or order to effectuate Section 9 of the GSA that states that Exelon Corporation, or any person employed by Exelon Corporation may provide services for other Parties, or any companies associated with the Parties, except as authorized by rule, regulation, or order of the SEC.

> Section 9. EXELON CORPORATION
>
> **Except as authorized by rule, regulation, or order of the SEC,** nothing in this Agreement shall be read to permit EXELON CORPORATION, or any person employed by or acting for EXELON

> CORPORATION, to provide services for other Parties, or any companies associated with said Parties.

Id. (emphasis added).

Since the parties to the GSA are no longer subject to the rule, regulation, or order of the SEC governing compliance under the GSA, Section 9 of the GSA is void.

Sixth, the SEC no longer has the authority to effectuate Section 10 of the GSA that states that Client Companies, their subsidiaries, affiliates and associates may provide services described within the GSA to other Client Companies on the same terms and conditions as set out in the GSA for the Service Company as limited by law or order of the SEC.

> Section 10. Client Companies
>
> **Except as limited by law or order of the SEC,** Client Companies, their subsidiaries, affiliates and associates may provide services described herein to other Client Companies, their subsidiaries, affiliates and associates on the same terms and conditions as set out for the Services Company.

Id. (emphasis added).

The GSA is no longer subject to the rule, regulation, or order of the SEC governing compliance under the GSA. Therefore, the GSA is void.

Seventh, the Commission does not review or approve the Service Level Arrangements ("SLAs") discussed by Ms. Brinkman that are established as the operational documents governing services provided by BSC to ComEd and reflect current services. (ComEd Ex. 12.0 REV, p. 19, lines 379 – 387.) While certain documents were provided to Staff via discovery in Docket No. 13-0318, documents obtained through that means are not normally made available for Commission review or approval.

The Commission takes its responsibilities under Section 7-101 of the Act seriously and the Company should provide timely periodic updates to the GSA to comply with current regulations. PUHCA 1935 is no longer effective. Service Companies are no longer subject to the rules and oversight by the SEC; Service Companies are subject to the regulation of FERC. The GSA approved by the Commission in Docket No. 00-0295 on November 7, 2001 is nearly thirteen years old and needs to be updated to require compliance by the Service Company with the Uniform System of Accounts set forth in 18 CFR 367; require compliance with the preservation of records set forth in 18 CFR 368; require submission of the FERC Form 60 as required by 18 CFR 369; and require compliance with the cross-subsidization restrictions on affiliate transactions set forth in 18 CFR 35.43 and 35.44. The contention that such an update would be burdensome does not excuse ComEd from periodically updating its GSA to be in compliance with current applicable laws and regulations.

Company witness Brinkman responds to Staff testimony with a listing of reports of BSC costs provided to Staff each year. (ComEd Ex 25.0, pp. 13-14.) These reports do not take the place of an updated GSA. In addition Ms. Brinkman states that the GSA approved by the Pennsylvania Public Utility Commission is the same document under discussion in this case. *Id.*, p. 15. The Illinois Commission is not bound by any approvals made in other jurisdictions. The Commission should Order ComEd to provide an updated GSA for approval by this Commission within 90 days of the date of the final order.

2. Customer Care Costs

<u>Introduction</u>

At issue is how much if any of ComEd's customer care costs should be allocated to ComEd's supply function and what method should be used to determine this. Customer care refers to various services provided by the Company to its customers that are complementary to the distribution ("delivery") of electricity. Customer care costs refer to the expenditures ComEd incurs that pertain to nearly every aspect of customers' interactions with ComEd's Meter Reading, Field and Meter Services, AMI implementation, Billing, Revenue Management, Revenue Protection, Cash Processing, the Contact Center, and Customer Relations departments, as well as costs related to back office support of these functions, such as Support Services, IT, and Large Customer Solutions ("LCS"). (Staff Ex. 4.0, p. 2.) The evidence in this proceeding indicates that the Company's proposed method of accounting for customer care costs, i.e., the Switching Study (also known as the "Avoided Cost Method"), presents a more reasonable approach than the Allocation Study ("embedded cost study") (presented by ComEd) strongly advocated for by RESA. Staff recommends that the Switching Study be adopted for use in this case for the allocation of customer care costs.

History of the Issue

The Commission has addressed ComEd's allocation of customer care costs in five prior proceedings. The issue arose in ICC Docket No. 05-0597, when a coalition of alternative energy suppliers ("CES") unsuccessfully requested that approximately 25% of ComEd's customer care costs be allocated to the supply function. This proposal was rejected by the Commission. Commonwealth Edison Co., ICC Order Docket No. 05-0597, 257 (July 26, 2006); (Staff Ex. 4.0, p. 3.) This issue was reintroduced in ICC Docket No. 07-0566 when the intervenor, the Coalition to Request Equitable Allocation of Costs Together ("REACT"), proposed to reallocate 40% of certain customer care costs to ComEd's supply function. Commonwealth Edison Co., ICC Order Docket No. 07-0566, 170 (September 10, 2008). While the Commission did not adopt the REACT proposal in that case, it stated that the issue was to be considered further in the Rate Design Investigation preceding it initiated, namely Docket No. 08-0532. Commonwealth Edison Co., ICC Order Docket No. 07-0566, 207-08 (Sept. 10, 2008); (Staff Ex. 4.0, p. 3.) In Docket No. 08-0532, the Commission directed ComEd "to file an embedded cost of service study for these costs and to also include the results of its avoided cost study. This will give the Commission the opportunity to review and compare both methodologies and reach a decision based on all the relevant information." Commonwealth Edison Co., ICC Order Docket No. 08-0532, 69 (April 21, 2010). The directive specifically referred to the filing of such study in its next rate case filing, which was Docket No. 10-0467.

Subsequently, two types of studies were provided in Docket No. 10-0467. One, coined as the "Switching Study," determined the share, if any, of customer care costs that are supply-related by assessing whether they are sensitive to the number of customers switching to supply service furnished by Alternative Retail Electric Suppliers ("ARES" or "RES"). The second was termed the "Allocation Study," which used an embedded cost approach to allocate customer care costs between supply and distribution functions. In that proceeding, the Switching Study concluded that even if customer switching were to increase from 1% to 10% or even 100%, the Company would not incur significant differences in customer care costs for bundled and unbundled customers. At the time when the proceeding was ongoing, ComEd experienced roughly a 1% switching rate. In fact, according to the Switching Study, it appeared that as more customers migrated to alternative suppliers, there would be a projected net increase in costs to ComEd. Ultimately, the Commission approved the Switching Study in that proceeding. (Staff Ex. 4.0, p. 6.) However, the issue of customer care cost allocation was not conclusively settled in Docket No. 10-0467. While approving the results of the Switching Study in that proceeding, the Commission directed ComEd to further explore the Customer Care Cost issue as market conditions change. (Commonwealth Edison Co., ICC Order Docket No. 10-0467, 210 (May 24, 2011); Staff Ex. 4.0, p. 6.)

The issue of ComEd's customer care cost allocation between the supply and delivery functions was once again addressed by the Commission in Docket No. 13-0387, the 2013 Rate Design Investigation ("2013 RDI"), in which the Commission concluded that accurate Customer Care Cost allocation would require ComEd to provide an updated customer care cost Allocation Study that allocates customer care costs between supply and delivery service functions in the Company's next formula rate update filing. (See Commonwealth Edison Co., ICC Order Docket No. 13-0387, 57 (Dec. 18, 2013); Staff Ex. 4.0, p. 7.)

Consistent with Commission's direction in Docket No. 13-0387 and in light of the fact that market conditions have in fact evolved significantly since this issue first arose, ComEd provided updated analyses with respect to the allocation of customer care costs utilizing three different methodologies, as discussed in detail in part D below.

Customer Care Costs in General

Customer care costs are currently recovered through delivery service charges, and this practice is consistent with the manner in which these costs have been recovered from customers since pricing for electric service was unbundled. (Staff Ex. 4.0, p. 2.) Since customer care costs are incurred to support both the distribution and supply functions, the issue in this proceeding concerns how much of these costs should be included in the distribution revenue requirement. Id. The resolution of that allocation issue determines whether and how customer care costs are to be recovered from ComEd customers receiving distribution only services ("unbundled customers") or both distribution and ComEd supply services ("bundled customers"). Id.

The Company began its analysis of the issue by identifying the amount of customer care costs that were incurred to serve customers. The Company's review of these costs focused on direct operations and maintenance ("O&M") costs pertaining to customer service. (See ComEd Ex. 7.0, p.44; Staff Ex. 4.0, p. 25.) Both RESA and Staff argue, however, that the Company's analysis of the customer care issue was deficient since it unreasonably limited the amount of customer care costs analyzed by including only direct O&M costs and excluded any indirect costs in its definition of customer care costs. Both RESA and Staff agree that, in order to be consistent with Commission's Final Order in Docket No. 10-0467, ComEd should consider "total costs," including direct operations and maintenance ("O&M"), indirect O&M, and capital costs. (Commonwealth Edison Co., ICC Order Docket No. 10-0467, 213 (May 24, 2011); see also RESA Ex. 1.0, 4; Staff Ex. 4.0, 25-26; Staff Ex. 4.0, p. 27-28.) Consequently, in rebuttal testimony, ComEd revised its analysis to include the costs associated with the full revenue requirement amount for customer care, which equals $374,578,469. (ComEd Ex. 16.0, p. 8.)

ComEd's Three Studies

ComEd presented three studies: the Switching Study, the Allocation Study, and an Alternative Study. It is ComEd's position that the provision of an updated Switching Study, along with the Alternative Study and the updated Allocation Study, allows for more appropriate direct comparisons between the studies and enables the Commission to consider the issue using the most up to date information available. (ComEd Ex. 12.0, p. 36.)

The starting point for all three studies is the same: the customer care costs from the pool of costs for 2013. (Staff Ex. 4.0, p. 8.) ComEd has re-examined customer care cost data and performed updated studies that attempt to address the re-allocation of customer care costs between its supply and delivery functions consistent with Commission's direction in Docket No. 13-0387. Id. First, the Company identified the amount of customer care costs that were incurred to serve customers. Id. Then it developed three separate methods of allocating those costs between the distribution and supply function. Id.

The first method, known as the "Allocation Study," uses the embedded cost approach to allocate customer care costs between the supply and distribution functions of the Company. Id. This approach removes a portion of the customer care cost from the distribution revenue requirement for allocation to the supply function. The second method, technically termed the "Switching Study," determines the share of customer care cost that are supply-related by assessing whether they are sensitive to the number of customers switching to supply service furnished by RESs. Id. While ComEd utilizes the Switching Study to evaluate the nature of customer service activities and to assign the related costs to its delivery and supply functions, the composition and level of costs included in ComEd's Switching Study are determined on an embedded cost basis Id. at 9; (ComEd Ex. 8.0, p. 26.) The third method is a hybrid, namely the "Alternative Study" (ComEd. Ex. 7.06), that is essentially a mix of the two previously discussed studies. The Alternative Study is a two-step costing method provided as a substitute approach to allocating ComEd's customer care costs in case "the Commission believes that from a policy perspective some level of ComEd's customer service costs should be allocated to its supply function." Id.; (ComEd Ex. 8.0, 26).

Allocation Study vs. Switching Study

ComEd's Switching Study (ComEd Ex. 16.02) (also known as the "Avoided Costing Method"), determines the share of customer care cost that are supply-related by assessing whether they are sensitive to the number of customers switching to supply service furnished by RES's. The Switching Study examines the effect of three customer switching scenarios on the Company's customer care costs. The degree to which the costs vary under the different scenarios is ComEd's measure of the relative cost of providing customer care to supply and distribution customers. (Staff Ex. 4.0, pp. 9-10.) The Switching Study examines the effect of three customer switching scenarios in which 64%, 69% and 100% of customers choose alternative suppliers. While ComEd utilized the same methodology for the 2014 Switching Study as previously utilized in Docket Nos. 08-0532 and 10-0467, there is however one important difference between the current study and its earlier versions. That difference is the level of actual switching. In

Docket No. 10-0467, ComEd examined scenarios where 1% (actually switching levels at the time), 10% (theoretically projected) and 100% (theoretically projected) of ComEd's customers choose alternative suppliers. At the time of Docket No. 10-0467, the 1%, 10% and 100% scenarios provided the most insight on how customers switching to a RES may impact its customer care costs. The 1% and 100% scenarios tested the high/low limits of switching impacts at the time when market conditions were drastically different from the present day. While ComEd employs the same Switching Study methodology in the instant proceeding, we have an opportunity not only to evaluate the updated study, but also evaluate whether the previous Switching Study accurately projected what would happen to ComEd's customer care costs under the much higher levels of switching that are occurring presently. Id. at 11. The current Switching Study employs switching levels of 64% (theoretically projected possible reduction from current switching levels), 69% (estimate of current levels of switching) and 100% (theoretically projected maximum future switching levels). Id. at 10-11.

According to the current data, despite the dramatic increase in switching levels, the Switching Study shows that the cost of providing customer care for unbundled customers is almost equal to the combined cost for bundled customers, i.e. customers that take supply from ComEd. (Staff Ex. 9.0, 12-13.) In fact, similar to the forecasts made in Docket Nos. 08-0532 and 10-0049, the current version of the Switching Study suggests that the Company does not incur significant differences in customer care costs for bundled and unbundled customers. In Docket No. 10-0467, the Commission stated the following:

> While the Commission acknowledges that ComEd's figures in the Switching Study regarding 10% or 100% of its

> customers switching suppliers are hypothetical, there is no evidence here indicating that ComEd's customer care costs would diminish to any significant degree, if 10% or a greater amount of its supply customers switched to retail electric suppliers.

Commonwealth Edison Co., ICC Order Docket No. 10-0467, 210 (May 24, 2011)(emphasis added). To the contrary, ComEd's customer care costs increased between 2008 and 2014 (1% for 2008, 1.4% for 2010, and 69% for 2014), i.e. from the time of Docket. No. 08-0532 through the current proceeding, in spite of customer switching. (Staff Ex. 4.0 p. 12; Staff Ex. 9.0, p. 13.) There have been no changes in circumstances that would justify the allocation of customer care costs to the supply function, especially given the fact that customer care costs have increased as switching from ComEd supply to RES supply has increased.

Overall, there are a number of reasons as to why the Switching Study is superior to the Allocation Study. First, the Switching Study recognizes that the cost of providing customer care for unbundled customers is almost equal to the combined cost for bundled customers. That is, customer care costs did not decline significantly even though fewer customers stayed with ComEd supply. (Staff Ex. 4.0 p. 12.) In fact, it is worth contrasting the results of the current version of the Switching Study to the one ComEd provided in Docket No. 10-0467. In Docket No. 10-0467, ComEd projected that if customer switching were to increase ten-fold from 1% to 10%, only a few hundred thousand dollars in additional customer care costs would be expended or saved as a result. In Docket No. 10-0467, ComEd also projected that its Customer Care Costs would increase under the 100% switching scenario, which strengthened the argument that there was no justification for allocating costs away from the distribution function.

ComEd is currently experiencing switching levels of roughly 69%. However, ComEd has realized no reduction in its customer care costs even though approximately 70% of ComEd's customers receive electric supply service from RESs. Id. at 13.

The Switching Study also recognizes that ComEd is the default provider that must stand ready to serve customers that have chosen to receive supply service from a RES. As the default supply service provider, *see* 220 ILCS 5/16-103(c), ComEd must meet its obligations as the Provider of Last Resort ("POLR"). Due to this obligation, ComEd simply cannot avoid costs which support its supply function because it cannot eliminate its role as the POLR, regardless of the number of customers obtaining electric supply from a RES. Id. at 14.

The Allocation Study, on the other hand, allocates customer care costs between the supply and distribution functions on an embedded cost basis. RESA summarily dismisses the Switching Study and contends that these costs should be allocated based on an embedded cost allocation between distribution and supply (i.e. as reflected in the Allocation Study). In essence, since ratemaking in Illinois is largely based on embedded cost, RESA considers it reasonable to apply that same approach to the functional allocation of these costs. Staff disagrees with RESA. The problem, as ComEd has correctly pointed out, is that the customer care costs ComEd incurs for bundled and unbundled customers are virtually the same. ComEd's customer care costs are incurred in providing and making available the same customer care services for all its customers regardless of the source of supply service. Therefore, it is appropriate for ComEd to recover these costs from all its customers, without some portion being recovered from just ComEd's supply customers. (Staff Ex. 9.0, p. 6-7.)

Staff also disputes RESA's argument that the Switching Study is inconsistent with embedded cost principles. The Switching Study is not inconsistent or incompatible with ComEd's embedded cost of service study. The Switching Study is merely another means of determining and demonstrating what portion of the remaining common costs are distribution-related and which are not. It is an added step in the direct assignment of costs that are attributable to the delivery service function, like meter reading. In fact, direct assignments were the starting point for both the Switching Study and Allocation Study. The direct assignment of costs is a common part of the development of an embedded cost of service study. In fact, utilities such as ComEd utilize a fully embedded and allocated cost of service study that breaks down the complexities of all direct, joint, and common costs by function and classification of cost causation. (Staff Ex. 9.0, p. 9.)

While RESA contends that the Switching Study is faulty partly because it does not adhere to embedded cost principles (RESA Ex. 1.0, p. 4), it is doubtful that the Allocation Study, (whether ComEd's version or RESA's "corrected" version) would achieve this goal instead. Because ComEd's ECOSS does not separate out the customer care costs identified in the Allocation Study nor does it include any identification of what supply choices residential or nonresidential customers have made, the Allocation Study does not closely adhere to embedded cost of service principles either, and therefore, it is not more accurate than the Switching Study in examining customer care costs. Id. at 10.

Furthermore, the application of the Allocation Study would shift a significant share of customer care costs to the supply function from ComEd's distribution service related revenue requirement. Under this approach, an unbundled delivery service customer could potentially bypass the supply-related portion of the customer care costs, assuming they are allocated and charged to bundle supply customers only. In fact, each switch from ComEd supply service to a RES's supply service could cause the charges for the recovery of such costs from the remaining ComEd supply service customers to increase. This result inevitably follows from the reality that these costs are not "avoidable" as discussed at length earlier, that is, these costs do not decrease as additional customers opt for RES supply. (Staff Ex. 4.0, p. 23.) Fundamentally, the results of the Allocation Study result in a subsidy. Subsidies do not foster efficient competition and do not support the concept of cost causation. Such subsidies distort prices, create inefficiencies, and potentially could increase costs to customers. Staff strongly believes that the Commission should not underprice what unbundled customers would pay for customer care costs, and overprice bundled customers in an effort to create an artificial allocation of these costs. (Staff Ex. 9.0, p. 17.)

After reviewing both methods, the Switching Study is the more reasonable approach to the functional allocation of customer care costs. The Company's arguments on these issues are persuasive. While the Switching Study approach has been historically questioned by the Commission, the current situation wherein switching levels have increased to 69% demonstrates that the Commission has made the right decision with respect to deeming the Switching Study in Docket No. 10-0467 to be credible, despite its reservations at the time. Id. at 20. The Switching Study's result appropriately recognizes that the Company does not incur significant differences in customer care costs for bundled and unbundled customers. The results of ComEd's Switching Study show that the current level of customers switching to Retail Electric Suppliers ("RES") service, which is 69%, has not made an impact on ComEd's costs related to customer care services and, thus, does not appear to be a significant cost issue for ComEd ratepayers. Id. at 16. In contrast, the Allocation Study is inherently an exploratory exercise not tied to the reality of ComEd's operations and sets up an artificial allocation of costs between supply and delivery. The Allocation Study, despite the fact that it is based on embedded cost of service principles, is based more on assumptions that are wholly unrelated to ComEd's actual customer service operations and the Company's experience with switching levels since 2008 with their associated costs. (Staff Ex. 4.0, p. 20.) Thus, there is no justification to treat these customers differently in the cost allocation process as the Allocation Study proposes to do.

As a final point, another consideration for Staff is that ComEd's treatment of customer care costs is similar to the treatment used by other utilities in Illinois. Staff is not aware of any electric or gas utility where customer care costs are allocated on an embedded cost basis between distribution and supply. If the Commission were to accept the Allocation Study instead, this would set an undesirable precedent not only for other electric utilities in Illinois, but for gas utilities as well. The same arguments could apply to any utility with significant supply costs relative to distribution costs. Id. at 15. Ever since the restructuring of the electric industry and the creation of delivery service rates, the Commission has consistently treated customer care costs as delivery service costs and allowed for their recovery through delivery service rates. Id. What's more, ComEd's treatment of customer care costs is similar to the treatment used by other utilities in the United States. Out of the 21 regulatory jurisdictions throughout the United

States identified in an industry-wide review offered by ComEd, there is not one jurisdiction that reallocates customer care costs among regulated entities from delivery to supply. Id. at 15-16; (ComEd Ex. 8.02.)

RES Proposed Adjustments to Allocation Study Allocators

If the Commission decides to adopt RESAs proposal to allocate customer care costs based upon an embedded cost basis using an Allocation Study, which it should not, the issue of allocators for the Allocation Study comes into play.

The starting point for the analysis by RESA is the Allocation Study presented by ComEd. RESA proposes several adjustments to the ComEd Allocation Study. Staff has a number of concerns about the specific allocators RESA proposes for these costs. (Staff Ex. 9.0, p. 22.) RESA contends that ComEd developed faulty allocators for its Allocation Study and that ComEd’s proposed allocators generate implausible results. (See RESA Ex. 1.0, 4, 12.) To address these perceived shortcomings, RESA identifies various adjustments that would further reallocate anywhere from $36.5 to $59 million to the default supply rate, depending which allocation methodology the Commission would chose. (RESA Ex. 2.0, pp. 30-31.) RESA adjusted a number of ComEd’s allocators, namely: revenue allocation, Id. at 13-15, Bill Allocator, Id. at 15, and bill calculation allocator, Id. at 17, and presented a few other miscellaneous adjustments. (Staff Ex. 9.0, pp. 22-23.)

RESA’s proposal is problematic. While Staff acknowledges that ComEd’s allocators are admittedly imperfect, they nevertheless present a reasonable attempt to determine a balanced allocation of these costs. However imperfect ComEd’s developed allocators may be, they are based upon the work functions of customer services and are certainly more logical than RESA's arbitrary adjustments. Id. at 23. One of the reasons RESA gives for making extensive adjustments to ComEd's Allocation Study allocators is the argument that ComEd's only basis for the validity of the allocators is the fact that ComEd calculated them, or as RESA puts it, "ComEd's calculations are largely a matter of self-reporting." (RESA Ex. 1.0, 9.) This is not true, however, as ComEd developed the allocators utilizing ComEd's knowledge of its own business and based them on how ComEd's business operates. In contrast, RESA's adjustments to the allocators are based solely on unsupported assumptions and have little relation to the actual facts and circumstances of ComEd's business operations. In short, RESA's criticism reflect a simplistic view of ComEd's customer services costs, which conveniently produces an allocation of customer care costs to supply of at least $36.5 to 59 million instead of the $21 million Allocation Study figure calculated by ComEd. (ComEd Ex. 16.01.)

Despite all of RESA's criticisms concerning ComEd's allegedly "flawed" allocators used in its Allocation Study, RESA presents no compelling arguments why, from a cost standpoint, its adjustments to these allocators renders them more accurate. For example, RESA proffers an adjustment to the bill calculation allocator. RESA notes that ComEd determined that 2 of 11 lines on the bill relate to supply and allocated billing costs based on this ratio. RESA argues that ComEd's resulting allocation of 81.8% for the delivery function and 18.2% for the supply function is flawed because "not all lines on a bill are created equally." (RESA Ex. 1.0, 16.) Ultimately, RESA concludes that the bill calculator allocator should, at a minimum, allocate 70.3% to the delivery function and 29.7% to the supply function utilizing its corrected revenue allocation methodology. Id. at 16-17. An application of the revenue allocator is not reasonable or based on any reasoned analysis. By ignoring the labor-driven nature of customer care costs and allocating such costs on the basis of revenues to ComEd's supply function, RESA simply ignores the nature of these costs and the Company's on-going incurrence of these costs in connection with delivery service. What's more, RESA's adjustment is also questionable given the fact that ComEd does not track whether customer care costs are related to supply or delivery service charges (Staff Ex. 9.0, p. 26) because, as stated earlier, customer care costs are incurred in providing and making available customer care services for all its customers regardless of the source of supply service. For example, when customers call ComEd with a billing concern, they call because of the total bill amount and not just one part of the bill. ComEd does not have its agents make a subjective judgment about why the bill is high. Therefore, it is appropriate for ComEd to recover these costs from all its customers rather than from a subset of its customers or from RESs providing service to its delivery service customers.

Another example of the irrational nature of RESA's adjustments to ComEd's Allocation Study is the recommendation that ComEd allocate 100% of $7,332,000 in charitable contributions (RESA Ex. 1.0, 22) to the supply function instead of the distribution function. However, RESA has not provided a compelling reason to warrant this treatment for costs that typically and historically have been recovered through base rates, not to mention that RESA's treatment of such costs is contrary to the Public Utilities Act, 220 ILCS 5/9-227. (Staff Ex. 9.0, p. 28.)

RESA dismisses ComEd's Allocation Study's ability to allocate costs between distribution and supply alleging that many of the allocators seem to have little to do with the costs they are purportedly allocating. (See, generally, RESA Ex. 1.0, 9-20.) RESA, however, fails to provide cost justification for the alternative allocators it proposes. In fact, RESA's use of revenues (i.e. use of a revenue allocator in place of where ComEd utilized another type of allocator which recognizes the labor-driven nature of these costs) as a basis for allocating costs between delivery and supply produces inappropriate results that do not reflect cost causation. ComEd has clearly established the proper methodology for establishing cost causation when performing its Allocation Study via the use of direct assignments, special studies and generally accepted functional allocators. Direct assignments establish the highest degree of correlation between the cost and the cause of the cost. The second best alternative for properly identifying cost causation with a function, class, or service would be some sort of special study such as the call center study that identifies a group of costs that can be split among two or more functions. The third alternative is to use a meaningful relationship such as an allocation study or generally accepted functional allocator (i.e. labor and/or rate base, etc.). (Staff Ex. 9.0, p. 30.) Finally, when all else fails, revenue could be considered as a method for functionalizing costs to functions, class or service. This is where RESA commits an error by using revenues as the allocation method of choice, according to which RESA adjusts ComEd's allocation of costs. Id. RESA's arbitrary adjustment appears to be a self-serving adjustment without any regard to ComEd's operations. Id. at 25. In fact, a comparable subjective allocation methodology was rejected time and again by the Commission in Docket Nos. 05-0597, 07-0566, 08-0532, and 10-0467. The fundamental underlying rationale for such a proposal remains unsupported in this proceeding as well. Essentially, adoption of RESA's allocation proposal would create disparities in rates between sales and delivery customers that would be difficult to justify from a cost standpoint. This would not be fair to either ComEd or its customers.

In sum, the Allocation Study presented in this proceeding represents a theoretical exercise that produces limited benefit to ComEd's customers. (Staff Ex. 9.0, p. 36.) The Allocation Study utilizes arbitrary allocation factors based on the assumption that ComEd could develop a more reasonable study in order to allocate customer care costs more "reasonably." Id. In other words, the Allocation Study is based upon a supposition that it is appropriate to allocate costs between distribution and supply merely because some find it intuitive to do so, rather than following cost causation principles. Id. The Switching Study more accurately captures the actual causation of ComEd's customer care services costs than the Allocation Study. The Switching Study comports with the Commission's treatment of customer services costs in the past, as part of delivery services costs. The Switching Study reflects the reality of ComEd's operations and avoids an arbitrary allocation between supply and distribution would not reflect cost causation. Id. ComEd must incur costs in order to always be ready to provide electric supply service for any or all customers. Moreover, ComEd has no control over the conditions under which customers may switch to ComEd for electric supply service. ComEd is subject to providing electric supply service based upon individual customer's elections, governmental authorities' aggregation choices, and RESs' business decisions (with respect to individual customers and/or overall activity in ComEd's service territory). (Staff Ex. 9.0, p. 19.) Therefore, the Commission should accept the results of the Switching Study (ComEd Ex. 16.02.)

Alternative Recommendation

While Staff does not support the use of allocation factors to segment customer care costs between delivery and supply functions, if the Commission adopts such an approach from a policy perspective, Staff recommends that the Commission adopt the results of ComEd's Alternative Analysis, ComEd Ex. 16.03, consisting of a two-step costing method that relies upon combination of embedded and avoided costing principles, which allocates $10,927,146 of ComEd's customer service costs to its delivery and supply functions. Staff recommends the Commission to utilize the results of the Alternative Analysis as this approach will minimize the impact of unbundling of the costs of a utility's customer service activities between its delivery and supply functions which is not an easy or straightforward undertaking, and is not generally undertaken elsewhere in the electric utility industry. (ComEd Ex. 8.0, p. 28.) This costing approach will recognize the common cost aspect associated with ComEd's customer service activities and the desire to quantify the portion of the associated costs that can be allocated to ComEd's supply function using acceptable and widely recognized costing principles Id. at 28-29.

In the alternative, the Commission can adopt the results of ComEd's Allocation Study, ComEd Ex. 16.01, which would allocate $21,386,393 of customer care costs from delivery to supply, and reject RESA's adjustments to ComEd's Allocation Study which would allocated $36.5 to $59 million dollars of ComEd's customer service costs to its delivery and supply functions. However, Staff cautions the Commission to adopt the results of the Allocation Study, which segments customer care costs between delivery and supply, as it would undoubtedly create additional unnecessary complications, which will have to be dealt with in future years to come. (Staff Ex. 9.0, p. 37.)

3. Capacity Unbundling

XI. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations regarding the Company's tariffs and charges submitted pursuant to Section 16-108.5 of the Public Utilities Act.

Respectfully submitted,

__/s/______________________

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